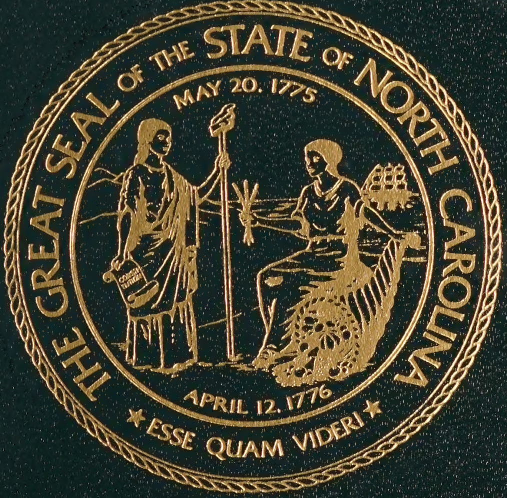
GENERAL STATUTES
OF
NORTH CAROLINA

ANNOTATED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GENERAL STATUTES OF NORTH CAROLINA

ANNOTATED

Volume 6

Chapters 25 Through 31

Prepared Under the Supervision of
THE DEPARTMENT OF JUSTICE
OF THE STATE OF NORTH CAROLINA
by
The Editorial Staff of the Publisher

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Preface

This volume contains the general laws of a permanent nature enacted by the General Assembly through the 2007 Regular Session and 1st Extra Session that are within Chapters 25 through 31, and brings to date the annotations included therein.

A majority of the Session Laws are made effective upon becoming law, but a few provide for stated effective dates. If the Session Law makes no provision for an effective date, the law becomes effective under G.S. 120-20 "from and after 60 days after the adjournment of the session" in which passed.

A ready reference index is included at the back of this volume. This index is intended to give the user a quick reference to larger bodies of statutes within this volume only. For detailed research on any subject, both within this volume and the General Statutes as a whole, see the General Index to the General Statutes.

Beginning with formal opinions issued by the North Carolina Attorney General on July 1, 1969, selected opinions which construe a specific statute are cited in the annotations to that statute. For a copy of an opinion or of its headnotes, write the Attorney General, P.O. Box 629, Raleigh, N.C. 27602.

This recompiled volume has been prepared and published under the supervision of the Department of Justice of the State of North Carolina. The members of the North Carolina Bar are requested to communicate any suggestions they may have for improving the General Statutes to the Department, or to LexisNexis, Charlottesville, Virginia.

Roy Cooper
Attorney General

Scope of Volume

Statutes:

Permanent portions of the General Laws enacted by the General Assembly through the 2007 Regular Session and 1st Extra Session affecting Chapters 25 through 31 of the General Statutes.

Annotations:

This publication contains annotations taken from decisions of the North Carolina Supreme Court, decisions of the North Carolina Court of Appeals, and decisions of the appropriate federal courts posted through September 21, 2007. These cases will be printed in the following reporters:

South Eastern Reporter 2nd Series.
Federal Reporter 3rd Series.
Federal Supplement 2nd Series.
Federal Rules Decisions.
Bankruptcy Reports.
Supreme Court Reporter.

Additionally, annotations have been taken from the following sources:

North Carolina Law Review.
Wake Forest Law Review.
Campbell Law Review.
Duke Law Journal.
North Carolina Central Law Journal.
Opinions of the Attorney General.

User's Guide

In order to assist both the legal profession and the layperson in obtaining the maximum benefit from the North Carolina General Statutes, a User's Guide has been included in Volume 1. This guide contains comments and information on the many features found within the General Statutes intended to increase the usefulness of this set of laws to the user. See Volume 1 for the complete User's Guide.

Abbreviations

(The abbreviations below are those found in the General Statutes that refer to prior codes.)

P.R.	Potter's Revisal (1821, 1827)
R.S.	Revised Statutes (1837)
R.C.	Revised Code (1854)
C.C.P.	Code of Civil Procedure (1868)
Code	Code (1883)
Rev.	Revisal of 1905
C.S.	Consolidated Statutes (1919, 1924)

STATE OF NORTH CAROLINA

Department of Justice

Raleigh, North Carolina

December 2007

I, Roy Cooper, Attorney General of North Carolina, do hereby certify that the foregoing 2007 Replacement Code to the General Statutes of North Carolina was prepared and published by LexisNexis under the supervision of the Department of Justice of the State of North Carolina.

Roy Cooper

Attorney General of North Carolina

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Editor's Note. — Former G.S. 25-1 to 25-199 (the N.I.L.) were repealed by Session Laws 1965, c. 700, which enacted the U.C.C.

To maintain uniformity with the commercial codes adopted by other states, the designation and indentation of subsections, subdivisions and further divisions of sections in Chapter 25 have not been changed to conform to the system and style employed elsewhere in the General Statutes. The numbering of sections corresponds to that used in the 1962 Official Text of the U.C.C., as amended, except that each number is preceded by the chapter number "25." Thus, "G.S. 1-101" of the Official Text is "G.S. 25-1-101" in this chapter.

Where sections of the U.C.C. are similar to sections repealed by Session Laws 1965, c. 700, the historical citations to the former sections have been added to the historical citations to the sections of the U.C.C.

Following each section of the U.C.C., Official Comments have been included. The Comments headed "North Carolina Comment" first appeared in "North Carolina Annotations — The Uniform Commercial Code," a 1965 report of the former Legislative Council to the General Assembly of North Carolina. Appropriate comments were selected at the time of initial publication of Chapter 25 and edited under the supervision of the Division of Legislative Drafting and Codification of Statutes of the Department of Justice. The Comments headed "Official Comment" are the Comments of the National Conference of Commissioners on Uniform State Laws and The American Law Institute which appeared in the "1962 Official Text with Comments" of the U.C.C., with the exceptions noted hereafter.

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Article 8 of Chapter 25 was amended in 1989 and again in 1997, and contains Amended Official Comments thereto.

Articles 2A and 4A of Chapter 25 were enacted by the General Assembly in 1993, and contain the Official Comments thereto.

Article 5 of Chapter 25 was revised in 1999 and contains revised Official Comments.

Article 9 was revised in 2000 and contains revised Official Comments thereto. This revised Article 9 supersedes the revision of Article 9 by Session Laws 1975, c. 862, s. 1.

Article 8 of Chapter 25 contains a North Carolina Comment to the 1989 revision. Articles 3 and 4 of Chapter 25 contain revised North Carolina Comments to the 1995 Revision. Article 5 of Chapter 25 contains two North Carolina Comments to the 1999 Revision.

The Official Comments and the North Carolina Comments printed in this Chapter have been printed by the publisher as received, without any significant editorial change.

The user should also note that Amended Official Comments have not been received in conjunction with all amendments to sections of the U.C.C., and therefore, subsequent amendments to the Official Comments and the North Carolina Comments may not be reflected in some instances.

The Comment under the title of the Act states in part: "Uniformity throughout American jurisdictions is one of the main objectives of this Code; and that objective cannot be obtained without substantial uniformity of construction. To aid in uniform construction these Comments set forth the purpose of various provisions of this Act to promote uniformity, to aid in viewing the Act as an integrated whole, and to safeguard against misconstruction."

ARTICLE 1.

General Provisions.

(Revised)

Editor's Note. — Official Comments in Article 1: Copyright 2001 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1.

GENERAL PROVISIONS.

§ 25-1-101. Short titles.

(a) This Chapter may be cited as the Uniform Commercial Code.

(b) This Article may be cited as Uniform Commercial Code — General Provisions. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-101.

Changes from former law: Subsection (b) is new. It is added in order to make the structure of Article 1 parallel with that of the other articles of the Uniform Commercial Code.

1. Each other article of the Uniform Commercial Code (except Articles 10 and 11) may also be cited by its own short title. See Sections 2-101, 2A-101, 3-101, 4-101, 4A-101, 5-101, 6-101, 7-101, 8-101, and 9-101.

Editor's Note. — Session Laws 2006-112, s. 1, effective October 1, 2006, rewrote Article 1 of Chapter 25 of the General Statutes. At the end of Article 1 are tables showing comparable sections and their disposition in new Article 1. Where appropriate, historical citations to sections of former Article 1 have been placed under corresponding sections of revised Article 1.

Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Session Laws 2006-112, s. 61, provides: "The Revisor of Statutes shall cause to be printed along with this act all relevant portions of the official comments to Uniform Commercial Code Revised Article 1 and Uniform Commercial Code Revised Article 7 and all explanatory comments of the drafters of this act as the Revisor deems appropriate."

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

For survey of 1980 commercial law, see 59 N.C.L. Rev. 1076 (1981).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23

Wake Forest L. Rev. 575 (1988).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

Cited in Szabo Food Serv., Inc. v. Balentine's, Inc., 285 N.C. 452, 206 S.E.2d 242 (1974); Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976); American Clipper Corp. v. Howerton, 51 N.C. App. 539, 277 S.E.2d 136 (1981); Gillespie v. DeWitt, 53 N.C. App. 252, 280 S.E.2d 736 (1981); Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986); Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

§ 25-1-102. Scope of Article.

Except as provided in G.S. 25-1-301, this Article applies to a transaction to the extent that it is governed by another Article of this Chapter. (2006-112, s. 1.)

OFFICIAL COMMENT

Source: New.

1. This section is intended to resolve confusion that has occasionally arisen as to the applicability of the substantive rules in this article. This section makes clear what has always been the case - the rules in Article 1 apply to transactions to the extent that those transactions are governed by one of the other articles of the Uniform Commercial Code. See also Comment 1 to Section 1-301.

NORTH CAROLINA COMMENT

The General Statutes Commission added the reference to G.S. 25-1-301 to make applicable that section's choice of law rules to a transaction that is not subject to the Uniform Commercial Code as enacted in this State but is governed by the Uniform Commercial Code as enacted in one or more other states with contacts to the transaction, as to which North Carolina law would not apply under G.S. 25-1-301.

§ 25-1-103. Construction of this Chapter to promote its purposes and policies; applicability of supplemental principles of law.

(a) This Chapter shall be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) To simplify, clarify, and modernize the law governing commercial transactions;

(2) To permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and

(3) To make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of this Chapter, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions. (1917, c. 37, s. 56; C.S., s. 4039; 1941, c. 353, s. 18; G.S., s. 55-98; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-102 (1)-(2); Former Section 1-103.

Changes from former law: This section is derived from subsections (1) and (2) of former

Section 1-102 and from former Section 1-103. Subsection (a) of this section combines subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, its language is the same as subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, subsection (b) of this section is identical to former Section 1-103. The provisions have been combined in this section to reflect the interrelationship between them.

1. The Uniform Commercial Code is drawn to provide flexibility so that, since it is intended to be a semi-permanent and infrequently-amended piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in the Uniform Commercial Code to be applied by the courts in the light of unforeseen and new circumstances and practices. The proper construction of the Uniform Commercial Code requires, of course, that its interpretation and application be limited to its reason.

Even prior to the enactment of the Uniform Commercial Code, courts were careful to keep broad acts from being hampered in their effects by later acts of limited scope. See *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1-104. The courts have often recognized that the policies embodied in an act are applicable in reason to subject-matter that was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature), and did the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They disregarded a statutory limitation of remedy where the reason of the limitation did not apply. *Fiterman v. J. N. Johnson & Co.*, 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.

The Uniform Commercial Code should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. **Applicability of supplemental principles of law.** Subsection (b) states the basic relationship of the Uniform Commercial Code to supplemental bodies of law. The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement it provisions in many important ways. At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers. Therefore, while principles of common law and equity may *supplement* provisions of the Uniform Commercial Code, they may not be used to supplant its provisions, or the purposes and policies those provisions reflect, unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Uniform Commercial Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Uniform Commercial Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant provisions of the Code. *See, e.g., Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from Comment 1 to former Section 1-103, which stated that "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act." The "explicitly displaced" language of that Comment did not accurately reflect the proper scope of Uniform Commercial Code preemption, which extends to displacement of other law that is inconsistent with the purposes and policies of the Uniform Commercial Code, as well as with its text.

3. **Application of subsection (b) to statutes.** The primary focus of Section 1-103 is on the relationship between the Uniform Commercial Code and principles of common law and equity as developed by the courts. State law, however, increasingly is statutory. Not only are there a growing number of state statutes addressing specific issues that come within the scope of the Uniform Commercial Code, but in some States many general principles of common law and equity have been codified. When the other law relating to a matter within the scope of the Uniform Commercial Code is a statute, the principles of subsection (b) remain relevant to the court's analysis of the relationship between that statute and the Uniform Commercial Code, but other principles of statutory interpretation that specifically address the interrelationship between statutes will be relevant as well. In some situations, the principles of subsection (b) still will be determinative. For example, the mere fact that an equitable principle is stated in statutory form rather than in judicial decisions should not change the court's analysis of whether the principle can be used to supplement the Uniform Commercial Code - under subsection (b), equitable principles may supplement provisions of the Uniform Commercial Code only if they are consistent with the purposes and policies of the Uniform Commercial Code as well as its text. In other situations, however, other interpretive principles addressing the interrelationship between statutes may lead the court to conclude that the other statute is controlling, even though it conflicts with the Uniform Commercial Code. This, for example, would be the result in a situation where the other statute was specifically intended to provide additional protection to a class of individuals engaging in transactions covered by the Uniform Commercial Code.

4. **Listing not exclusive.** The list of sources of supplemental law in subsection (b) is intended to be merely illustrative of the other law that may supplement the Uniform Commercial Code, and is not exclusive. No listing could be exhaustive. Further, the fact that a particular section of the Uniform Commercial Code makes express reference to other law is not intended to suggest the negation of the general application of the principles of subsection (b). Note also that the word "bankruptcy" in subsection (b), continuing the use of that word from former Section 1-103, should be understood not as a specific reference to federal bankruptcy law but, rather as a reference to general principles of insolvency, whether under federal or state law.

Legal Periodicals. — For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For note on promissory estoppel as regards subcontractors' liability in construction bidding cases, in light of Allen M. Campbell Co. v. Virginia Metal Indus., Inc., 708 F.2d 930 (4th Cir. 1983), see 63 N.C.L. Rev. 387 (1985).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions, " see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Editor's Note. *— Some of the cases cited below were decided under former G.S. 25-1-102 and G.S. 25-1-103.*

The provisions of the UCC are not exclusive and do not preclude an action for unfair and deceptive trade practices. United Va. Bank v. Air-Lift Assocs., 79 N.C. App. 315, 339 S.E.2d 90 (1986).

Chapter 75 is applicable to commercial transactions which are also regulated by the UCC. United Va. Bank v. Air-Lift Assocs., 79 N.C. App. 315, 339 S.E.2d 90 (1986).

Termination of Petroleum Franchise. — The Petroleum Marketing Practices Act, 15 U.S.C. § 2806(a), did not preempt G.S. 75-1.1 or subsection (3) of this section or the common law duty of good faith dealing as they arose in litigation involving wrongful termination of a franchise. L.C. Williams Oil Co. v. Exxon Corp., 627 F. Supp. 864 (M.D.N.C. 1985).

Use of Cases from Other Jurisdictions. — Cases from other jurisdictions, including some opinions by referees in bankruptcy and by the federal district courts, were not necessarily authoritative in this jurisdiction, but the Court of Appeals would look to them for guidance and explanation, remembering that one of the purposes of the Uniform Commercial Code is "to make uniform the law among various jurisdictions." Evans v. Everett, 10 N.C. App. 435, 179 S.E.2d 120, rev'd on other grounds, 279 N.C. 352, 183 S.E.2d 109 (1971).

A contractual provision expanding seller's damages upon breach of the buyer will be upheld where the contractual provision is reasonable and in good faith. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Parties were free to shape their remedies

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according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Trust Doctrine. — One principle made applicable by this section is the doctrine of trust pursuit, under which a cestui que trust is enabled to follow the trust funds through changes in their state and form in the hands of the trustee. Michigan Nat'l Bank v. Flowers Mobile Homes Sales, 26 N.C. App. 690, 217 S.E.2d 108 (1975).

Rescission. — Assuming without deciding that rescission remains available to a buyer as a remedy by virtue of this section, the Supreme Court gave effect to a buyer's allegation of "rescission" as an allegation of "revocation of acceptance" since that Code concept more nearly reflected the claims asserted by the buyer. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Supplier's failure to modify express terms of contract with distributor could not be considered violative of the UCC's concept of good faith, as the purpose of the good faith obligation is to determine the terms to be implied in the contract when the terms are not expressly provided. L.C. Williams Oil Co. v. Exxon Corp., 625 F. Supp. 477 (M.D.N.C. 1985).

§ 25-1-104. Construction against implied repeal.

This Chapter being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-104.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-104.

1. This section embodies the policy that an act that bears evidence of carefully considered permanent regulative intention should not lightly be regarded as impliedly repealed by subsequent legislation. The Uniform Commercial Code, carefully integrated and intended as a uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal.

§ 25-1-105. Severability.

If any provision or clause of this Chapter or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this Chapter that can be given effect without the invalid provision or application, and to this end the provisions of this Chapter are severable. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-108.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-108.

1. This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

§ 25-1-106. Use of singular and plural; gender.

In this Chapter, unless the statutory context otherwise requires:

(1) Words in the singular number include the plural, and those in the plural include the singular; and

(2) Words of any gender also refer to any other gender. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-102(5). See also 1 U.S.C. Section 1.

Changes from former law: Other than minor stylistic changes, this section is identical to former Section 1-102(5).

1. This section makes it clear that the use of singular or plural in the text of the Uniform Commercial Code is generally only a matter of drafting style - singular words may be applied in the plural, and plural words may be applied in the singular. Only when it is clear from the statutory context that the use of the singular or plural does not include the other is this rule inapplicable. *See, e.g.*, Section 9-322.

§ 25-1-107. Section captions.

Section captions are part of this Chapter. The subsection headings in Article 9 of this Chapter are not parts of this Chapter. (1965, c. 700, s. 1; 2000-169, s. 4; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-109.

Changes from former law: None.

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Article 9. See Comment 3 to Section 9-101 ("subsection headings are not a part of the official text itself and have not been approved by the sponsors.").

NORTH CAROLINA COMMENT

The General Statutes Commission added the second sentence of this section to bring forward the second sentence of former G.S. 25-1-109.

§ 25-1-108. Relation to Electronic Signatures in Global and National Commerce Act.

This Article modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001, et seq., except that nothing in this Article modifies, limits, or supersedes Section 7001(c) of that Act or authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act. (2006-112, s. 1.)

OFFICIAL COMMENT

Source:

New.

1. The federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq* became effective in 2000. Section 102(a) of that Act provides that a State statute may modify, limit, or supersede the provisions of section 101 of that Act with respect to state law if such statute, *inter alia*, specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts or other records, and (i) such alternative procedures or requirements are consistent with Titles I and II of that Act, (ii) such alternative procedures or requirements do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures; and (iii) if enacted or adopted after the date of the enactment of that Act, makes specific reference to that Act. Article 1 fulfills the first two of those three criteria; this Section fulfills the third criterion listed above.

2. As stated in this section, however, Article 1 does not modify, limit, or supersede Section 101(c) of the Electronic Signatures in Global and National Commerce Act (requiring affirmative consent from a consumer to electronic delivery of transactional disclosures that are

required by state law to be in writing); nor does it authorize electronic delivery of any of the notices described in Section 103(b) of that Act.

PART 2.

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION.

§ 25-1-201. General definitions.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other Articles of this Chapter that apply to particular Articles or Parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of this Chapter that apply to particular articles or parts thereof:

(1) "Action," in the sense of a judicial proceeding, includes recoupment, counterclaim, setoff, suit in equity, and any other proceeding in which rights are determined.

(2) "Aggrieved party" means a party entitled to pursue a remedy.

(3) "Agreement," as distinguished from "contract," means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in G.S. 25-1-303.

(4) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) "Bearer" means a person in control of a negotiable electronic document of title or a person in possession of a negotiable instrument, negotiable tangible document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of directly or indirectly transporting or forwarding goods. The term does not include a warehouse receipt.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing" a fact means the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 of this Chapter may be a buyer in ordinary course of business. "Buyer in ordinary course of business" does not include a person that acquires

goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "Conspicuous," with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

a. A heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

b. Language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

(11) "Consumer" means an individual who enters into a transaction primarily for personal, family, or household purposes.

(12) "Contract," as distinguished from "agreement," means the total legal obligation that results from the parties' agreement as determined by this Chapter as supplemented by any other applicable laws.

(13) "Creditor" includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate.

(14) "Defendant" includes a person in the position of defendant in a counterclaim, cross-claim, or third-party claim.

(15) "Delivery", with respect to an electronic document of title means voluntary transfer of control and with respect to an instrument, a tangible document of title, or chattel paper, means voluntary transfer of possession.

(16) "Document of title" means a record (i) that in the regular course of business or financing is treated as adequately evidencing that the person in possession or control of the record is entitled to receive, control, hold, and dispose of the record and the goods the record covers and (ii) that purports to be issued by or addressed to a bailee and to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass. The term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt, and order for delivery of goods. An electronic document of title means a document of title evidenced by a record consisting of information stored in an electronic medium. A tangible document of title means a document of title evidenced by a record consisting of information that is inscribed on a tangible medium.

(17) "Fault" means a default, breach, or wrongful act or omission.

(18) "Fungible goods" means:

a. Goods of which any unit, by nature or usage of trade, are the equivalent of any other like unit; or

b. Goods that by agreement are treated as equivalent.

(19) "Genuine" means free of forgery or counterfeiting.

(20) "Good faith," except as otherwise provided in Article 5 of this Chapter, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(21) "Holder" means:

a. The person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession;

b. The person in possession of a negotiable tangible document of title if the goods are deliverable either to bearer or to the order of the person in possession; or

c. The person in control of a negotiable electronic document of title.

(22) "Insolvency proceeding" includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(23) "Insolvent" means:

a. Having generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute;

b. Being unable to pay debts as they become due; or

c. Being insolvent within the meaning of federal bankruptcy law.

(24) "Money" means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

(25) "Organization" means a person other than an individual.

(26) "Party," as distinguished from "third party," means a person that has engaged in a transaction or made an agreement subject to this Chapter.

(27) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

(28) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(29) "Purchase" means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(30) "Purchaser" means a person that takes by purchase.

(31) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(33) "Representative" means a person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate.

(34) "Right" includes remedy.

(35) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. "Security interest" includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9 of this Chapter. "Security interest" does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under G.S. 25-2-401, but a buyer may also acquire a "security interest" by complying with Article 9 of this Chapter. Except as otherwise provided in G.S. 25-2-505, the right of a seller or lessor of goods under Article 2 or 2A of this Chapter to retain or acquire possession of the goods is not a "security interest," but a seller or lessor may also acquire a

"security interest" by complying with Article 9 of this Chapter. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under G.S. 25-2-401 is limited in effect to a reservation of a "security interest." Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to G.S. 25-1-203.

(36) "Send" in connection with a writing, record, or notice means:
  a. To deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and, in the case of an instrument, to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances; or
  b. In any other way to cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "Signed" includes using any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "Surety" includes a guarantor or other secondary obligor.

(40) "Term" means a portion of an agreement that relates to a particular matter.

(41) "Unauthorized signature" means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "Warehouse receipt" means a document of title issued by a person engaged in the business of storing goods for hire.

(43) "Writing" includes printing, typewriting, or any other intentional reduction to tangible form. "Written" has a corresponding meaning. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2; 1995, c. 232, s. 3; 2000-169, ss. 5-7; 2006-112, ss. 1, 26.)

OFFICIAL COMMENTS

Source: Former Section 1-201.

Changes from former law: In order to make it clear that all definitions in the Uniform Commercial Code (not just those appearing in Article 1, as stated in former Section 1-201, but also those appearing in other Articles) do not apply if the context otherwise requires, a new subsection (a) to that effect has been added, and the definitions now appear in subsection (b). The reference in subsection (a) to the "context" is intended to refer to the context in which the defined term is used in the Uniform Commercial Code. In other words, the definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. Consider, for example, Sections 3-103(a)(9) (defining "promise," in relevant part, as "a written undertaking to pay money signed by the person undertaking to pay") and 3-303(a)(1) (indicating that an instrument is issued or transferred for value if "the instrument is issued or transferred for a promise of performance, to the extent that the promise has been performed." It is clear from the statutory context of the use of the word "promise" in Section 3-303(a)(1) that the term was not used in the sense of its definition in Section 3-103(a)(9). Thus, the Section 3-103(a)(9) definition should not be used to give meaning to the word "promise" in Section 3-303(a).

Some definitions in former Section 1-201 have been reformulated as substantive provisions and have been moved to other sections. See Sections 1-202 (explicating concepts of notice and knowledge formerly addressed in Sections 1-201(25)-(27)), 1-204 (determining when a person gives value for rights, replacing the definition of "value" in former Section 1-201(44)), and 1-206 (addressing the meaning of presumptions, replacing the definitions of "presumption" and "presumed" in former Section 1-201(31)). Similarly, the portion of the definition of "security interest" in former Section 1-201(37) which explained the difference between a security interest and a lease has been relocated to Section 1-203.

Two definitions in former Section 1-201 have been deleted. The definition of "honor" in former Section 1-201(21) has been moved to Section 2-103(1)(b), inasmuch as the definition only applies to the use of the word in Article 2. The definition of "telegram" in former Section 1-201(41) has been deleted because that word no longer appears in the definition of "conspicuous."

Other than minor stylistic changes and renumbering, the remaining definitions in this section are as in former Article 1 except as noted below.

1. "Action." Unchanged from former Section 1-201, which was derived from similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

2. "Aggrieved party." Unchanged from former Section 1-201.

3. "Agreement." Derived from former Section 1-201. As used in the Uniform Commercial Code the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of the Uniform Commercial Code to displace a stated rule of law. Whether an agreement has legal consequences is determined by applicable provisions of the Uniform Commercial Code and, to the extent provided in Section 1-103, by the law of contracts.

4. "Bank." Derived from Section 4A-104.

5. "Bearer." Unchanged from former Section 1-201, which was derived from Section 191, Uniform Negotiable Instruments Law.

6. "Bill of Lading." Derived from former Section 1-201. The reference to, and definition of, an "airbill" has been deleted as no longer necessary.

7. "Branch." Unchanged from former Section 1-201.

8. "Burden of establishing a fact." Unchanged from former Section 1-201.

9. "Buyer in ordinary course of business." Except for minor stylistic changes, identical to former Section 1-201 (as amended in conjunction with the 1999 revisions to Article 9). The major significance of the phrase lies in Section 2-403 and in the Article on Secured Transactions (Article 9).

The first sentence of paragraph (9) makes clear that a buyer from a pawnbroker cannot be a buyer in ordinary course of business. The second sentence explains what it means to buy "in the ordinary course." The penultimate sentence prevents a buyer that does not have the right to possession as against the seller from being a buyer in ordinary course of business. Concerning when a buyer obtains possessory rights, see Sections 2-502 and 2-716. However, the penultimate sentence is not intended to affect a buyer's status as a buyer in ordinary course of business in cases (such as a "drop shipment") involving delivery by the seller to a person buying from the buyer or a donee from the buyer. The requirement relates to whether as against the seller the buyer or one taking through the buyer has possessory rights.

10. "Conspicuous." Derived from former Section 1-201(10). This definition states the general standard that to be conspicuous a term ought to be noticed by a reasonable person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention-calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test.

11. "Consumer." Derived from Section 9-102(a)(25).

12. "Contract." Except for minor stylistic changes, identical to former Section 1-201.

13. "Creditor." Unchanged from former Section 1-201.

14. "Defendant." Except for minor stylistic changes, identical to former Section 1-201, which was derived from Section 76, Uniform Sales Act.

15. "Delivery." Derived from former Section 1-201. The reference to certificated securities has been deleted in light of the more specific treatment of the matter in Section 8-301.

16. "Document of title." Unchanged from former Section 1-201, which was derived from Section 76, Uniform Sales Act. By making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in *Hixson v. Ward,* 254 Ill.App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already

opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title." The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this section regardless of the name given to the instrument.

The goods must be "described," but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

17. "Fault." Derived from former Section 1-201. "Default" has been added to the list of events constituting fault.

18. "Fungible goods." Derived from former Section 1-201. References to securities have been deleted because Article 8 no longer uses the term "fungible" to describe securities. Accordingly, this provision now defines the concept only in the context of goods.

19. "Genuine." Unchanged from former Section 1-201.

20. "Good faith." Former Section 1-201(19) defined "good faith" simply as honesty in fact; the definition contained no element of commercial reasonableness. Initially, that definition applied throughout the Code with only one exception. Former Section 2-103(1)(b) provided that "in this Article... good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." This alternative definition was limited in applicability in three ways. First, it applied only to transactions within the scope of Article 2. Second, it applied only to merchants. Third, strictly construed it applied only to uses of the phrase "good faith" in Article 2; thus, so construed it would not define "good faith" for its most important use — the obligation of good faith imposed by former Section 1-203.

Over time, however, amendments to the Uniform Commercial Code brought the Article 2 merchant concept of good faith (subjective honesty and objective commercial reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See Section 2A-103(7). Then, other Articles broadened the applicability of that standard by adopting it for all parties rather than just for merchants. See, e.g., Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10), and 9-102(a)(43). All of these definitions are comprised of two elements- honesty in fact and the observance of reasonable commercial standards of fair dealing. Only revised Article 5 defines "good faith" solely in terms of subjective honesty, and only Article 6 and Article 7 are without definitions of good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2 to revised Section 6-102 states that "this Article adopts the definition of 'good faith' in Article 1 in all cases, even when the buyer is a merchant.") Given these developments, it is appropriate to move the broader definition of "good faith" to Article 1. Of course, this definition is subject to the applicability of the narrower definition in revised Article 5.

21. "Holder." Derived from former Section 1-201. The definition has been reorganized for clarity.

22. "Insolvency proceedings." Unchanged from former Section 1-201.

23. "Insolvent." Derived from former Section 1-201. The three tests of insolvency- "generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute as to them," "unable to pay debts as they become due," and "insolvent within the meaning of the federal bankruptcy law" — are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money." Substantively identical to former Section 1-201. The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Organization." The former definition of this word has been replaced with the standard

definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

26. "Party." Substantively identical to former Section 1-201. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to the principal, particular account is taken of that situation.

27. "Person." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

28. "Present value." This definition was formerly contained within the definition of "security interest" in former Section 1-201(37).

29. "Purchase." Derived from former Section 1-201. The form of definition has been changed from "includes" to "means."

30. "Purchaser." Unchanged from former Section 1-201.

31. "Record." Derived from Section 9-102(a)(69).

32. "Remedy." Unchanged from former Section 1-201. The purpose is to make it clear that both remedy and right (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under the Uniform Commercial Code, remedial rights being those to which an aggrieved party may resort on its own.

33. "Representative." Derived from former Section 1-201. Reorganized, and form changed from "includes" to "means."

34. "Right." Except for minor stylistic changes, identical to former Section 1-201.

35. "Security Interest." The definition is the first paragraph of the definition of "security interest" in former Section 1-201, with minor stylistic changes. The remaining portion of that definition has been moved to Section 1-203. Note that, because of the scope of Article 9, the term includes the interest of certain outright buyers of certain kinds of property.

36. "Send." Derived from former Section 1-201. Compare "notifies".

37. "Signed." Derived from former Section 1-201. Former Section 1-201 referred to "intention to authenticate"; because other articles now use the term "authenticate," the language has been changed to "intention to adopt or accept." The latter formulation is derived from the definition of "authenticate" in Section 9-102(a)(7). This provision refers only to writings, because the term "signed," as used in some articles, refers only to writings. This provision also makes it clear that, as the term "signed" is used in the Uniform Commercial Code, a complete signature is not necessary. The symbol may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible situations can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to adopt or accept the writing.

38. "State." This is the standard definition of the term used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

39. "Surety." This definition makes it clear that "surety" includes all secondary obligors, not just those whose obligation refers to the person obligated as a surety. As to the nature of secondary obligations generally, see Restatement (Third), Suretyship and Guaranty Section 1 (1996).

40. "Term." Unchanged from former Section 1-201.

41. "Unauthorized signature." Unchanged from former Section 1-201.

42. "Warehouse receipt." Unchanged from former Section 1-201, which was derived from Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

43. "Written" or "writing." Unchanged from former Section 1-201.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Effect of Amendments. — Session Laws 2006-112, s. 26, effective October 1, 2006, in subsection (b), inserted "a person in control of a negotiable electronic document of title or" and "negotiable tangible" in subdivision (5), inserted "of title" and "directly or indirectly" in the first sentence and added the second sentence of subdivision (6), inserted "to an electronic document of title means voluntary transfer of control and with respect" and "a tangible" in subdivision (15), rewrote subdivision (16), inserted "negotiable tangible" in subdivision (21)b., added subdivision (21)c., and made minor stylistic changes, and substituted "document of title" for "receipt" in subdivision (42).

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

Editor's Note. — *Most of the cases cited below were decided under former G.S. 25-1-201.*

The UCC protects buyers in the ordinary course of business from the claims of predecessors in interest who place items into the stream of commerce without warning that they subsequently will claim ownership. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

"Conspicuousness". — Determination on conspicuousness is a question of law for the court. Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976); Angola Farm Supply & Equip. Co. v. FMC Corp., 59 N.C. App. 272, 296 S.E.2d 503 (1982).

Language on herbicide to the effect that seller made "no other express or implied warranty of fitness or merchantability or any other express or implied warranty," which was in darker and larger type than the other language on the label, was "conspicuous," as defined by subdivision (10) of this section, and served to effectively disclaim any implied warranties of merchantability or fitness. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Forum selection clause was conspicuous where, although the font used in the forum selection clause could have been made larger, the forum selection language was found in two places on the front page of an agreement, both times in bold print and underlined. Price v. Leasecomm Corp., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 5467 (M.D.N.C. Mar. 31, 2004).

"Delivery". — Delivery of a deed or instrument to the named payee, subject to the control of the person delivering it or subject to an agreed condition, does not constitute delivery in the eyes of the law. State v. First Resort Properties, 81 N.C. App. 499, 344 S.E.2d 354 (1986).

"Send." — Creditor's effort to notify debtors of private sale by sending a first class letter to debtors' last known address was reasonable where there was no evidence that the letter was returned, or that the debtors did not receive such notice, or that the debtors had provided creditor with a new address. In re Marshall, 219 Bankr. 687 (Bankr. M.D.N.C. 1997).

Good faith ("honesty in fact") and "notice," although not synonymous, are inherently intertwined. Therefore, the relation between the two cannot be ignored. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

The same facts which call a party's "good faith" into question may also give him "notice of a defense." Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Albeit "good faith" is literally defined as "honesty in fact in the conduct or transaction concerned," the Uniform Commercial Code does not permit parties to intentionally keep themselves in ignorance of facts which, if known, would defeat their rights in a negotiable document of title. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Honesty in Fact Required of Supplier. — A good faith duty requiring a supplier of products to disclose its internal strategies to distributors was inappropriate, as the breadth of good faith required was limited to the "honesty in fact" definition of this section, which governed distributor's claim under G.S. 25-1-203, rather than the more expansive "reasonable commercial standards of fair dealing in the trade" definition of G.S. 25-2-103. L.C. Williams Oil Co. v. Exxon Corp., 625 F. Supp. 477 (M.D.N.C. 1985).

"Holder". — The definition of "holder" in subdivision (20) of this section is applicable to G.S. 45-21.16. In re Cooke, 37 N.C. App. 575, 246 S.E.2d 801 (1978).

Ownership is not indispensable to

holdership. In re Cooke, 37 N.C. App. 575, 246 S.E.2d 801 (1978).

Where a negotiable instrument is made payable to order, one becomes a holder of the instrument when it is properly endorsed and delivered to him, and mere possession of a note payable to order does not suffice to prove ownership or holder status. Econo-Travel Motor Hotel Corp. v. Taylor, 301 N.C. 200, 271 S.E.2d 54 (1980).

There was ample evidence that the beneficiaries of a deed of trust were holders of a valid debt where the notes secured by the deed of trust were payable to the beneficiaries or order, the notes were not endorsed, and the notes were in the possession of the original beneficiary-payees. In re Cooke, 37 N.C. App. 575, 246 S.E.2d 801 (1978).

As evidence that a plaintiff is holder of a note is an essential element of a cause of action upon such note, the defendant was entitled to demand strict proof of this element. The incorporation by reference into the complaint of a copy of the note was not in itself sufficient evidence to establish for purposes of summary judgment that the plaintiff was the holder of the note. Liles v. Myers, 38 N.C. App. 525, 248 S.E.2d 385 (1978).

It is the fact of possession which is significant in determining whether a person is a holder, and the absence of possession defeats that status. Connolly v. Potts, 63 N.C. App. 547, 306 S.E.2d 123 (1983).

Bank which had cancelled and released a promissory note because of a clerical error, and therefore was not a "holder" in the traditional sense, could still meet the burden required by this section by showing that debtor never satisfied the underlying obligation. G.E. Capital Mtg. Servs. v. Neely, 135 N.C. App. 187, 519 S.E.2d 553 (1999).

An indorsement by an authorized agent of the "holder" is sufficient to validate the transaction. s Summerlin v. National Serv. Indus., Inc., 72 N.C. App. 476, 325 S.E.2d 12 (1985).

"Money". — Debtors' interest in unearned portion of a retainer paid to a law firm was a general intangible and as such, a creditor with a properly perfected security interest had a lien on the balance of the retainer fund; in reaching its determination that the retainer was a general intangible, the bankruptcy court reasoned that the debtors' interest in the retainer was neither a deposit account (because the law firm was not a bank or financial institution) or "money" (because the debtors had only the right to receive a refund on the unearned portion of the retainer fund). In re E-Z Serve Convenience Stores, Inc., 299 B.R. 126, 2003 Bankr. LEXIS 1358 (Bankr. M.D.N.C. 2003), aff'd, 318 Bankr. 637 (M.D.N.C. 2004).

"Rights". — The term "all rights" in an assignment included the contractual right of assignor to receive C.O.D. payment from defendant. Gunby v. Pilot Freight Carriers, Inc., 82 N.C. App. 427, 346 S.E.2d 188 (1986).

"Security Interest". — This section defines "security interest" without reference to whether title is in the vendor or the vendee under the security agreement. Szabo Food Serv., Inc. v. Balentine's, Inc., 285 N.C. 452, 206 S.E.2d 242 (1974).

Clause (b) of subsection (37) is not consistent with the fundamental proposition that to create a security interest the parties must have intended to create one. Szabo Food Serv., Inc. v. Balentine's, Inc., 285 N.C. 452, 206 S.E.2d 242 (1974).

The language of a promissory note considered together with the terms and language of a financing statement may be sufficient to create a security interest in collateral owned by the debtor on the note. Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

A financing statement can serve as a written security agreement to satisfy G.S. 25-9-203(1)(b). Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

Article 9 of this Chapter applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Security Interest v. Lease. — Where a debtor could terminate her rental agreement for a VCR and a washing machine at any time with no further obligation to continue paying rent, the agreement was a "true" lease, not a security interest, under subdivision (37) of this section. In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

An agreement purporting to lease equipment actually was a secured loan, where the lessee could purchase the equipment for $1 upon termination of the lease, the total monthly lease payments approximated the purchase price, the lessor was a financing company, the lessee was not responsible for maintenance, insurance, taxes, and expenses, and the transaction was referred to as a loan in the parties' agreement. L.C. Williams Oil Co. v. NAFCO Capital Corp., 130 N.C. App. 286, 502 S.E.2d 415 (1998).

No Assignment of Security Interest. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

"Signed". — Because of the importance placed upon financing statements, in cases dealing with the debtor's signature on financing statements the courts should apply the liberal definition of "signed" in subsection (39) of this section with caution. Provident Fin. Co. v. Beneficial Fin. Co., 36 N.C. App. 401, 245 S.E.2d 510, cert. denied, 295 N.C. 549, 248 S.E.2d 728 (1978).

"Warehouse Receipt". — "Household Goods Descriptive Inventory" was sufficient to constitute a warehouse receipt for purposes of holding defendant moving company responsible under Art. 7 for its actions as a warehouseman where the document listed each item picked up, its condition, the owner's name, the origin loading address, and was signed and dated by defendant's authorized agent and driver. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989), cert. denied, 326 N.C. 54, 389 S.E.2d 104 (1990).

Arbitration Is Neither an "Action" nor a "Judicial Proceeding." — By its terms the limitations period stated in G.S. 25-2-725 applies only to an "action," which, under subsection (1) is a "judicial proceeding," and an arbitration is neither an "action" nor a "judicial proceeding," but a nonjudicial, out-of-court proceeding which makes an action or judicial proceeding unnecessary. In re Cameron, 91 N.C. App. 164, 370 S.E.2d 704 (1988).

§ 25-1-202. Notice; knowledge.

(a) Subject to subsection (f) of this section, a person has "notice" of a fact if the person:

(1) Has actual knowledge of it;

(2) Has received a notice or notification of it; or

(3) From all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) "Knowledge" means actual knowledge. "Knows" has a corresponding meaning.

(c) "Discover," "learn," or words of similar import refer to knowledge rather than to reason to know.

(d) A person "notifies" or "gives" a notice or notification to another person by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it.

(e) Subject to subsection (f) of this section, a person "receives" a notice or notification when:

(1) It comes to that person's attention; or

(2) It is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made or at another location held out by that person as the place for receipt of such communications.

(f) Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2; 1995, c. 232, s. 3; 2000-169, ss. 5-7; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Derived from former Section 1-201(25)-(27).

Changes from former law: These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from Section 1-201 to this section. The reference to the "forgotten notice" doctrine has been deleted.

1. Under subsection (a), a person has notice of a fact when, *inter alia*, the person has received a notification of the fact in question.

2. As provided in subsection (d), the word "notifies" is used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send." When the essential fact is the other party's receipt of the notice, that is stated. Subsection (e) states when a notification is received.

3. Subsection (f) makes clear that notice, knowledge, or a notification, although "received," for instance, by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

§ 25-1-203. Lease distinguished from security interest.

(a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

(1) The original term of the lease is equal to or greater than the remaining economic life of the goods;

(2) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because:

(1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;

(2) The lessee assumes risk of loss of the goods;

(3) The lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;

(4) The lessee has an option to renew the lease or to become the owner of the goods;

(5) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(6) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) When the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) When the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2; 1995, c. 232, s. 3; 2000-169, ss. 5-7; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-201(37).

Changes from former law: This section is substantively identical to those portions of former Section 1-201(37) that distinguished "true" leases from security interests, except that the definition of "present value" formerly embedded in Section 1-201(37) has been placed in Section 1-201(28).

1. An interest in personal property or fixtures which secures payment or performance of an obligation is a "security interest." See Section 1-201(37). Security interests are sometimes created by transactions in the form of leases. Because it can be difficult to distinguish leases that create security interests from those that do not, this section provides rules that govern the determination of whether a transaction in the form of a lease creates a security interest.

2. One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that created considerable confusion in the courts: what is a lease? The confusion existed, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act, Section 1-201(37). The confusion was compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy...." 1 G. Gilmore, *Security Interests in Personal Property* Section 3.6, at 76 (1965).

Under pre-UCC chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing-Leveraged Leasing* 681, 700 n.25, 729 n.80 (2d ed.1980). The Article on Leases (Article 2A) did not change the law in that respect, except for leases of fixtures. Section 2A-309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) of the 1978 Official Text of the Act provided that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.*, leases intended as security; however, the definition became vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this Article.

This section begins where Section 1-201(35) leaves off. It draws a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to enactment of the rules now codified in this section, the 1978 Official Text of Section 1-201(37) provided that whether a lease was intended as security (*i.e.*, a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest led to unfortunate results. In discovering intent, courts relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, were as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, this section contains no reference to the parties' intent.

Subsections (a) and (b) were originally taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to the incorporation of those concepts in this article will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9*, 47 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. Subsection (b) further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, *e.g., In re Royer's Bakery, Inc.*, 1 U.C.C. Rep.Serv. (Callaghan) 342 (Bankr. E.D.Pa. 1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (1), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (2), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters.*, 1 Bankr. 647, 651-52 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (3), is whether the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014-15 (Bankr. E.D.Tenn. 1984). The fourth of these tests, subparagraph (4), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371-73 (Bankr. W.D.Wis. 1983).

The focus on economics is reinforced by subsection (c). It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (1) has no statutory derivative; it states that a full payout lease does not per se create a security interest. *Rushton v. Shea*, 419 F.Supp. 1349, 1365 (D.Del. 1976). Subparagraphs (2) and (3) provide the same regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v. Ochs*, 42 Or.App. 319, 600 P.2d 899 (Ct.App. 1979), with *In re Tillery*, 571 F.2d 1361 (5th Cir. 1978). Subparagraph (4) restates and expands the provisions of the 1978 Official Text of Section 1-201(37) to make clear that the option can be to buy or renew. Subparagraphs (5) and (6) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. *Compare Arnold Mach. Co. v. Balls*, 624 P.2d 678 (Utah 1981), with *Aoki v. Shepherd Mach. Co.*, 665 F.2d 941 (9th Cir.1982).

The relationship of subsection (b) to subsection (c) deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir. 1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

Subsections (d) and (e) provide definitions and rules of construction.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-201.*

"Security Interest." — This section defines "security interest" without reference to whether title is in the vendor or the vendee under the security agreement. Szabo Food Serv., Inc. v. Balentine's, Inc., 285 N.C. 452, 206 S.E.2d 242 (1974).

Clause (b) of subsection (37) is not consistent with the fundamental proposition that to create a security interest the parties must have intended to create one. Szabo Food Serv., Inc. v. Balentine's, Inc., 285 N.C. 452, 206 S.E.2d 242 (1974).

The language of a promissory note considered together with the terms and language of a financing statement may be sufficient to create a security interest in collateral owned by the debtor on the note. Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

A financing statement can serve as a written security agreement to satisfy G.S. 25-9-203(1)(b). Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

Article 9 of this Chapter applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Security Interest v. Lease. — Where a debtor could terminate her rental agreement for a VCR and a washing machine at any time with no further obligation to continue paying rent, the agreement was a "true" lease, not a security interest, under subdivision (37) of this section. In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

An agreement purporting to lease equipment actually was a secured loan, where the lessee could purchase the equipment for $1 upon termination of the lease, the total monthly lease payments approximated the purchase price, the lessor was a financing company, the lessee was not responsible for maintenance, insurance, taxes, and expenses, and the transaction was referred to as a loan in the parties' agreement. L.C. Williams Oil Co. v. NAFCO Capital Corp., 130 N.C. App. 286, 502 S.E.2d 415 (1998).

§ 25-1-204. Value.

Except as otherwise provided in Articles 3, 4, and 5 of this Chapter, a person gives value for rights if the person acquires them:

(1) In return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;

(2) As security for, or in total or partial satisfaction of, a preexisting claim;

(3) By accepting delivery under a preexisting contract for purchase; or

(4) In return for any consideration sufficient to support a simple contract. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2; 1995, c. 232, s. 3; 2000-169, ss. 5-7; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-201(44).

Changes from former law: Unchanged from former Section 1-201, which was derived from Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from former Section 1-201 to this section.

1. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value." All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre-existing claim. Subsections (1), (2), and (4) in substance continue the definitions of "value" in the earlier acts. Subsection (3) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4-208, 4-209, 3-303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

***Editor's Note.** — The cases cited below were decided under former G.S. 25-1-201.*

"Value." — Where a finance company refused to finance a vehicle because debtors failed to qualify, the finance company had no lien to assign to the creditor that ultimately extended financing and recorded its lien post-petition; the creditor's reliance on former G.S. 25-1-201(44) (see now G.S. 25-1-204) was misplaced because there were numerous conditions that had to be satisfied before the finance company became bound to extend credit, none of which were ever satisfied. In re Josephs, — Bankr. —, 2005 Bankr. LEXIS 1421 (Bankr. M.D.N.C. July 15, 2005).

§ 25-1-205. Reasonable time; seasonableness.

(a) Whether a time for taking an action required by this Chapter is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time. (1899, c. 733, s. 193; Rev., s. 2343; C.S., s. 2978; 1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-204(2)-(3).

Changes from former law: This section is derived from subsections (2) and (3) of former Section 1-204. Subsection (1) of that section is now incorporated in Section 1-302(b).

1. Subsection (a) makes it clear that requirements that actions be taken within a "reasonable" time are to be applied in the transactional context of the particular action.

2. Under subsection (b), the agreement that fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

Legal Periodicals. — For discussion of the "reasonable notice" aspect of warranty law, in light of Maybank v. S.S. Kresge, 302 N.C. 129, 273 S.E.2d 681 (1981), see 61 N.C.L. Rev. 177 (1982).

§ 25-1-206. Presumptions.

Whenever this Chapter creates a "presumption" with respect to a fact, or provides that a fact is "presumed," the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2; 1995, c. 232, s. 3; 2000-169, ss. 5-7; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-201(31).

Changes from former law. None, other than stylistic changes.

1. Several sections of the Uniform Commercial Code state that there is a "presumption" as to a certain fact, or that the fact is "presumed." This section, derived from the definition appearing in former Section 1-201(31), indicates the effect of those provisions on the proof process.

PART 3.

TERRITORIAL APPLICABILITY AND GENERAL RULES.

§ 25-1-301. Territorial applicability; parties' power to choose applicable law.

(a) Except as otherwise provided in this section, when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties.

(b) In the absence of an agreement effective under subsection (a) of this section, and except as provided in subsection (c) of this section, this Chapter applies to transactions bearing an appropriate relation to this State.

(c) If one of the following provisions of this Chapter specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:

(c)(1) G.S. 25-2-402;
 (2) G.S. 25-2A-105 and G.S. 25-2A-106;
 (3) G.S. 25-4-102;
 (4) G.S. 25-4A-507;
 (5) G.S. 25-5-116;
 (6) G.S. 25-8-110;
 (7) G.S. 25-9-301 through G.S. 25-9-307. (1965, c. 700, s. 1; 1975, c. 862, s. 1; 1993, c. 157, s. 2; 1997-181, s. 17; 1999-73, s. 2; 2000-169, s. 3; 2004-190, s. 2; 2006-112, s. 1.)

NORTH CAROLINA COMMENT

The Official Comment to this section is omitted.

This section brings forward former G.S. 25-1-105, with some stylistic changes, in lieu of Section 1-301 of Revised Article 1. As of the time this Article was enacted in this State, no state that had enacted Revised Article 1 had adopted revised Section 1-301; states that have enacted Revised Article 1 have instead chosen to continue the former provision.

Appendix to North Carolina Comment The following is the text of the 1999 edition of the Official Comment to former Section 1-105:

1. Subsection (1) [subsection (a)] states affirmatively the right of the parties to a multistate transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the five sections [and two groups of sections] listed in subsection (2) [subsection (c)], and is limited to jurisdictions to which the transaction bears a "reasonable relation." In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in *Seeman v. Philadelphia Warehouse Co.,* 274 U.S. 403, 47 S.Ct. 626, 71 L.Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the Act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of course, the Act applies to any transaction which takes place in its entirety in a state which has enacted the Act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code.

3. Where a transaction has significant contacts with a state which has enacted the Act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction

may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. *Compare Global Commerce Corp. v. Clark-Babbitt Industries, Inc.,* 239 F.2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the Code, application of another law to some detail of performance because of an accident or geography may violate the commercial understanding of the parties.

4. The Act does not attempt to prescribe choice-of-law rules for states which do not enact it, but this section does not prevent application of the Act in a court of such a state. Common-law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.

5. Subsection (2) [subsection (c)] spells out essential limitations on the parties' right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.

6. Sections 9-301 through 9-307 should be consulted as to the rules for perfection of security interests and agricultural liens, the effect of perfection and non-perfection, and priority.

Legal Periodicals. — For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-105.*

Purpose. — Purpose for adopting subsection (1) (now subsections (a) and (b)), was to change North Carolina's adherence to lex loci contractus approach, which focuses on place of entering contract and on place of performance to determine which law governs contract disputes. Terry v. Pullman Trailmobile, 92 N.C. App. 687, 376 S.E.2d 47 (1989).

UCC provides its own choice of law rule, modifying the traditional place-of-contractor-performance rule previously applied in this state. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Section Changes Rigid Conflict of Laws Rules. — The provisions of this section were intended to change the rigid conflict of laws rules. The old rules must give way to the requirements of the Code. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

This section modifies traditional conflict of law rules. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

The enactment of this section was intended to change this State's rigid choice of law rules with respect to transactions under the UCC. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Importance of Section. — As the North Carolina Comment which follows this section points out, this section is one of the most important preliminary sections of the UCC and it modifies this State's conflict of laws rules. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

Transaction causing personal injury to a plaintiff in this State has "an appropriate relation" to this State within the meaning of this section. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

Actions Based on Breach of Warranty. — In determining which jurisdiction's law is applicable to actions based on breach of warranty, a court no longer looks only to where the contract was made or where it was intended to be performed. Rather, it looks to whether the transaction bears an appropriate relation to the State. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

A state's interest in enforcing warranties involves protection of its citizens from commercial movement of defective goods into that state. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Where defendant, a North Carolina brake manufacturer, initially distributed his product from North Carolina into Kentucky, and plaintiff's injury as a result of a malfunction of brakes supplied by defendant took place in North Carolina, North Carolina law applied to plaintiff's breach of warranty claim. Mahoney v. Ronnie's Road Serv., 122 N.C. App. 150, 468 S.E.2d 279 (1996), aff'd per curiam, 345 N.C. 631, 481 S.E.2d 85 (1997).

UCC is silent on the meaning of the term "appropriate relation," leaving its interpretation to judicial decision. Boudreau v.

Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

"Appropriate Relation" Defined. — The North Carolina Supreme Court has interpreted "appropriate relation" to mean "most significant relationship." Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Stipulation as to Law Governing Contract. — North Carolina permits the parties to a contract to stipulate the state whose law is to govern the contract if that state has a reasonable relationship to the transaction. Kaplan v. RCA Corp., 783 F.2d 463 (4th Cir. 1986).

Where defendant maintained its principal offices in New Jersey, the contract documents were prepared (and finally accepted) in New Jersey, and the antenna which was the subject of the suit was designed, engineered and tested there, New Jersey had a reasonable relationship to the transaction so as to permit the parties to stipulate that its law would govern. Kaplan v. RCA Corp., 783 F.2d 463 (4th Cir. 1986).

Where the transaction bears a reasonable relation to more than one state, the UCC permits the parties to agree with respect to which state's law shall govern their rights and duties. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

Where the goods in question were located in Texas and performance was due in this State, the transaction bore a reasonable relationship to both states, and pursuant to the agreement of the parties, the substantive issues involved would be resolved by application of Texas law. Procedural issues, however, would be determined by application of the law of North Carolina. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

State with the Most Significant Relationship to Warranty Claims. — Where Florida was the place of sale, distribution, delivery, and use of the product, as well as the place of injury, in a products liability action, Florida was the state with the most significant relationship to the warranty claims. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Where plaintiff was severely injured while operating tractor-trailer and where plaintiff alleged that accident was caused by defective design, manufacture, and assembly of trailer, because sale and distribution occurred in North Carolina, trial court properly applied North Carolina law to plaintiff's breach of warranty claims. Terry v. Pullman Trailmobile, 92 N.C. App. 687, 376 S.E.2d 47 (1989).

§ 25-1-302. Variation by agreement.

(a) Except as otherwise provided in subsection (b) of this section or elsewhere in this Chapter, the effect of provisions of this Chapter may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by this Chapter may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this Chapter requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of this Chapter of the phrase "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section. (1899, c. 733, s. 193; Rev., s. 2343; C.S., s. 2978; 1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Sections 1-102(3)-(4) and 1-204(1).

Changes: This section combines the rules from subsections (3) and (4) of former Section 1-102 and subsection (1) of former Section 1-204. No substantive changes are made.

1. Subsection (a) states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Uniform Commercial Code seeks to avoid the type of interference with evolutionary growth found in pre-Code cases such as *Manhattan Co. v. Morgan,* 242 N.Y. 38, 150 N.E. 594 (1926). Thus, private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in the Uniform Commercial

Code. But an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201 and 1-303; the effect of an agreement on the rights of third parties is left to specific provisions of the Uniform Commercial Code and to supplementary principles applicable under Section 1-103. The rights of third parties under Section 9-317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Uniform Commercial Code and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; Section 9-602, on the other hand, is a quite explicit limitation on freedom of contract. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform Commercial Code]," provisions of the Uniform Commercial Code prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1-303 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

Subsection (b) also recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. An agreement that varies the effect of provisions of the Uniform Commercial Code may do so by stating the rules that will govern in lieu of the provisions varied. Alternatively, the parties may vary the effect of such provisions by stating that their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions. Such bodies of rules or principles may include, for example, those that are promulgated by intergovernmental authorities such as UNCITRAL or Unidroit (*see, e.g.*, Unidroit Principles of International Commercial Contracts), or non-legal codes such as trade codes.

3. Subsection (c) is intended to make it clear that, as a matter of drafting, phrases such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (b), but absence of such words contains no negative implication since under subsection (b) the general and residual rule is that the effect of all provisions of the Uniform Commercial Code may be varied by agreement.

Legal Periodicals. — For discussion of the "reasonable notice" aspect of warranty law, in light of Maybank v. S.S. Kresge, 302 N.C. 129, 273 S.E.2d 681 (1981), see 61 N.C.L. Rev. 177 (1982).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-102.*

Use of Cases from Other Jurisdictions. — Cases from other jurisdictions, including some opinions by referees in bankruptcy and by the federal district courts, were not necessarily authoritative in this jurisdiction, but the Court of Appeals would look to them for guidance and explanation, remembering that one of the purposes of the Uniform Commercial Code is "to make uniform the law among various jurisdictions." Evans v. Everett, 10 N.C. App. 435, 179 S.E.2d 120.

A contractual provision expanding seller's damages upon breach of the buyer will be upheld where the contractual provision is reasonable and in good faith. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

§ 25-1-303. Course of performance, course of dealing, and usage of trade.

(a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

(1) The agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) The other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f) of this section, the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable:

(1) Express terms prevail over course of performance, course of dealing, and usage of trade;

(2) Course of performance prevails over course of dealing and usage of trade; and

(3) Course of dealing prevails over usage of trade.

(f) Subject to G.S. 25-2-209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Sections 1-205, 2-208, and Section 2A-207.

Changes from former law: This section integrates the "course of performance" concept from Articles 2 and 2A into the principles of former Section 1-205, which deals with course of dealing and usage of trade. In so doing, the section slightly modifies the articulation of the course of performance rules to fit more comfortably with the approach and structure of former Section 1-205. There are also slight modifications to be more consistent with the definition of "agreement" in former Section 1-201(3). It should be noted that a course of performance that might otherwise establish a defense to the obligation of a party to a negotiable instrument is not available as a defense against a holder in due course who took the instrument without notice of that course of performance.

1. The Uniform Commercial Code rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. In-

stead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. "Course of dealing," as defined in subsection (b), is restricted, literally, to a sequence of conduct between the parties previous to the agreement. A sequence of conduct after or under the agreement, however, is a "course of performance." "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

3. The Uniform Commercial Code deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement that the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade," the Uniform Commercial Code expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law." A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

4. A usage of trade under subsection (c) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal," or the like. Under the requirement of subsection (c) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

5. The policies of the Uniform Commercial Code controlling explicit unconscionable contracts and clauses (Sections 1-304, 2-302) apply to implicit clauses that rest on usage of trade and carry forward the policy underlying the ancient requirement that a custom or usage must be "reasonable." However, the emphasis is shifted. The very fact of commercial acceptance makes out a *prima facie* case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

6. Subsection (d), giving the prescribed effect to usages of which the parties "are or should be aware," reinforces the provision of subsection (c) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (c) that such usages may be either general to trade or particular to a special branch of trade.

7. Although the definition of "agreement" in Section 1-201 includes the elements of course of performance, course of dealing, and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-302(c).

8. In cases of a well established line of usage varying from the general rules of the Uniform Commercial Code where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

9. Subsection (g) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

Legal Periodicals. — For article, "Stock Equipment for the Bargain in Fact: Trade Usage, Express Terms, and Consistency Under Section 1-205 of the Uniform Commercial Code," see 64 N.C.L. Rev. 777 (1986).

For article, "Court Adjustment of Long-Term

Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-205.*

Trade Usage May Be Matter of Fact or Law. — Ordinarily, the existence and the scope of a usage of trade are questions of fact to be determined by the fact finder. When, however, it is established that a usage of trade is embodied in a written code or similar writing, the interpretation of the writing becomes a question of law for the court. Superior Foods, Inc. v. Harris-Teeter Super Mkts., Inc., 288 N.C. 213, 217 S.E.2d 566 (1975).

Subsequent Conduct. — As a course of dealing is a sequence of "previous conduct" between the parties, conduct of the parties after they entered into an agreement could not be used to show a course of dealing. GATX Logistics, Inc. v. Lowe's Cos., 143 N.C. App. 695, 548 S.E.2d 193, 2001 N.C. App. LEXIS 338 (2001).

Express Contract Definition Prevailed. — In a manufacturer's action against a seller and individuals, alleging the breach of contract and other claims, although the course of dealing between the parties as to the type of products covered by the agreement indicated a narrower definition of "product" than that asserted by the manufacturer, under former G.S. 25-1-205 the express definition in the contract prevailed because it was different from that suggested by the parties' course of dealing and it would have been unreasonable to construe the two consistently; however, while the course of performance could not be interpreted to change the express definition of "product" in the agreement, a reasonable jury could have found that the seller provided sufficient evidence that the course of performance acted as a modification of the express definition, creating a genuine issue of material fact in the resolution of the parties' disputes under the agreement and precluding the grant of either the seller's or the manufacturer's motion for summary judgment. Interstate Narrow Fabrics, Inc. v. Century USA, Inc., 218 F.R.D. 455, 2003 U.S. Dist. LEXIS 18227 (M.D.N.C. 2003).

§ 25-1-304. Obligation of good faith.

Every contract or duty within this Chapter imposes an obligation of good faith in its performance and enforcement. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-203.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-203.

1. This section sets forth a basic principle running throughout the Uniform Commercial Code. The principle is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-303 on course of dealing, course of performance, and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

2. "Performance and enforcement" of contracts and duties within the Uniform Commercial Code include the exercise of rights created by the Uniform Commercial Code.

Legal Periodicals. — For discussion of the limitations on the obligation of good faith, see 1981, 4 Duke Law J. 619.

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

Application of the Uniform Commercial Code to Option Contracts for the Sale of Goods, and Implying Promises to Find Sufficient Consideration: Why and How the North Carolina Supreme Court Got It Wrong in Fordham v. Eason, 23 Campbell L. Rev. 49 (2000).

CASE NOTES

Editor's Note. *— The cases cited below were decided under former G.S. 25-1-203.*

Honesty in Fact Required of Supplier. — A good faith duty requiring a supplier of products to disclose its internal strategies to distributors was inappropriate, as the breadth of good faith required was limited to the "honesty in fact" definition of former G.S. 25-1-201, which governed distributor's claim under this section, rather than the more expansive "reasonable commercial standards of fair dealing in the trade" definition of former G.S. 25-2-203. L.C. Williams Oil Co. v. Exxon Corp., 625 F. Supp. 477 (M.D.N.C. 1985).

Course of Dealing Modifying Contract Term. — In a manufacturer's action against a seller and individuals, alleging the breach of contract and other claims, the seller's evidence of the parties' dealings under a prior contract and their subsequent dealings under the contract at issue indicated a course of dealing as contemplated in former G.S. 25-1-203 that could have modified the term "product" in the contract. Interstate Narrow Fabrics, Inc. v. Century USA, Inc., 218 F.R.D. 455, 2003 U.S. Dist. LEXIS 18227 (M.D.N.C. 2003).

Good Faith Obligation Not Breached. — Apparel company did not breach its obligation of good faith in the performance of its contract with an apparel assembler where (1) there was no evidence to support the assembler's claim that the company failed to provide it with sufficient cut parts under the contract, rather, the evidence showed that, despite having sufficient cut parts, the assembler often failed to meet the contract production levels, (2) the company did not induce the assembler to invest in T-shirt manufacturing machinery or to rely on alleged promises of continued work as the parties did not negotiate a new agreement regarding T-shirt production, and (3) the company did not unlawfully conceal the fact that it was building its own shirt manufacturing capability with the intent of terminating its relationship with the assembler as the parties' contract stated that the assembler was not the company's sole supplier, the contract gave the company the power to determine the assembler's quantities and to terminate their relationship, and the company did not have any obligation to disclose its future plans to the assembler. Sara Lee Corp. v. Quality Mfg., 201 F. Supp. 2d 608, 2002 U.S. Dist. LEXIS 27687 (M.D.N.C. 2002).

§ 25-1-305. Remedies to be liberally administered.

(a) The remedies provided by this Chapter shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed, but neither consequential or special damages nor penal damages may be had except as specifically provided in this Chapter or by other rule of law.

(b) Any right or obligation declared by this Chapter is enforceable by action unless the provision declaring it specifies a different and limited effect. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-106.

Changes from former law: Other than changes in the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-106.

1. Subsection (a) is intended to effect three propositions. The first is to negate the possibility of unduly narrow or technical interpretation of remedial provisions by providing that the remedies in the Uniform Commercial Code are to be liberally administered to the end stated in this section. The second is to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Uniform Commercial Code elsewhere makes it clear that damages must be minimized. Cf. Sections 1-304, 2-706(1), and 2-712(2). The third purpose of subsection (a) is to reject any doctrine that damages must be calculable with

mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

2. Under subsection (b), any right or obligation described in the Uniform Commercial Code is enforceable by action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716.

3. "Consequential" or "special" damages and "penal" damages are not defined in the Uniform Commercial Code; rather, these terms are used in the sense in which they are used outside the Uniform Commercial Code.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

***Editor's Note.** — The case cited below was decided under former G.S. 25-1-106.*

Purpose of Point 4 of Official Comment to G.S. 25-2-715. — It was to bring the law into harmony with the market place that the draftsmen of the Uniform Commercial Code said in Point 4 of the Official Comment to G.S. 25-2-715: "The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances." Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

§ 25-1-306. Waiver or renunciation of claim or right after breach.

A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-107.

Changes from former law: This section changes former law in two respects. First, former Section 1-107, requiring the "delivery" of a "written waiver or renunciation" merges the separate concepts of the aggrieved party's agreement to forego rights and the manifestation of that agreement. This section separates those concepts, and explicitly requires agreement of the aggrieved party. Second, the revised section reflects developments in electronic commerce by providing for memorialization in an authenticated record. In this context, a party may "authenticate" a record by (i) signing a record that is a writing or (ii) attaching to or logically associating with a record that is not a writing an electronic sound, symbol or process with the present intent to adopt or accept the record. See Sections 1-201(b)(37) and 9-102(a)(7).

1. This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where the agreement effecting such renunciation is memorialized in a record authenticated by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1-304).

CASE NOTES

***Editor's Note.** — The case cited below was decided under former G.S. 25-1-107.*

Acceptance of Full Payment. — This section does not change the common-law rule regarding acceptance of a "full payment check." Sharpe v. Nationwide Mut. Fire Ins. Co., 62 N.C. App. 564, 302 S.E.2d 893, cert. denied, 309 N.C. 823, 310 S.E.2d 353 (1983).

§ 25-1-307. Prima facie evidence by third-party documents.

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-202.

Changes from former law: Except for minor stylistic changes, this Section is identical to former Section 1-202.

1. This section supplies judicial recognition for documents that are relied upon as trustworthy by commercial parties.

2. This section is concerned only with documents that have been given a preferred status by the parties themselves who have required their procurement in the agreement, and for this reason the applicability of the section is limited to actions arising out of the contract that authorized or required the document. The list of documents is intended to be illustrative and not exclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

4. Documents governed by this section need not be writings if records in another medium are generally relied upon in the context.

CASE NOTES

***Editor's Note.** — The cases cited below were decided under former G.S. 25-1-202.*

The bill of lading is evidence of the fact that the goods were delivered in good condition in the absence of notation or entry thereon to the contrary. American Home Prods. Corp. v. Howell's Motor Freight, Inc., 46 N.C. App. 276, 264 S.E.2d 774 (1980).

While a nonnotated bill of lading was some evidence of good condition at time of receipt, it was not sufficient alone to survive a motion for directed verdict where the bill of lading contained the words "in apparent good order, contents and condition of package unknown." American Home Prods. Corp. v. Howell's Motor Freight, Inc., 46 N.C. App. 276, 264 S.E.2d 774 (1980).

§ 25-1-308. Performance or acceptance under reservation of rights.

(a) A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest," or the like are sufficient.

(b) Subsection (a) of this section does not apply to an accord and satisfaction. (1965, c. 700, s. 1; 1995, c. 232, s. 4; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-207.

Changes from former law: This section is identical to former Section 1-207.

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to accep-

tance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Subsection (b) states that this section does not apply to an accord and satisfaction. Section 3-311 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 applies, this section has no application to an accord and satisfaction.

Legal Periodicals. — For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For survey of 1980 commercial law, see 59 N.C.L. Rev. 1076 (1981).

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-207.*

This section does not apply to a check tendered in full payment of a disputed claim. Thus, a disputed claim for compensation for employment was extinguished when the debtor-employer tendered to the creditor-employee a check marked "account in full" and the creditor deposited the check after striking these words from the check and notified the debtor he was reserving his right to contend for the balance of the claim. Brown v. Coastal Truckways, Inc., 44 N.C. App. 454, 261 S.E.2d 266 (1980).

This section does not apply to a "full payment check," that is a check marked with some indication that it is tendered in full payment of a disputed claim. Barber v. White, 46 N.C. App. 110, 264 S.E.2d 385 (1980).

Reservation of Right to Collect Remainder of Unpaid Account. — Where debtor pays thirty-five percent of an account with checks bearing on the face of one the words "first instalment of agreed settlement" and on the other "final instalment of agreed settlement," the creditor reserves its right to collect the remainder of the unpaid account when it indorses the checks "with reservation of all our rights." Baillie Lumber Co. v. Kincaid Carolina Corp., 4 N.C. App. 342, 167 S.E.2d 85 (1969).

§ 25-1-309. Option to accelerate at will.

A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure," or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised. (1965, c. 700, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENTS

Source: Former Section 1-208.

Changes from former law: Except for minor stylistic changes, this section is identical to former Section 1-208.

1. The common use of acceleration clauses in many transactions governed by the Uniform Commercial Code, including sales of goods on credit, notes payable at a definite time, and secured transactions, raises an issue as to the effect to be given to a clause that seemingly grants the power to accelerate at the whim and caprice of one party. This section is intended to make clear that despite language that might be so construed and which further might be held

to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an obligation of payment or performance which in the first instance is due at a future date.

Legal Periodicals. — For note on the operation of a due-on-sale clause in a deed of trust to allow a lender to exact higher interest rates from the grantee of a mortgagor, see 13 Wake Forest L. Rev. 490 (1977).

CASE NOTES

Editor's Note. — *The cases cited below were decided under former G.S. 25-1-208.*

"Good Faith" Standard Applicable Only to Insecurity Clauses. — This section imposes the "good faith" standard in G.S. 25-1-201(19) (now G.S. 25-1-201(20)) only on insecurity-type clauses. Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580 (1976).

Insecurity and Default Clauses Distinguished. — Insecurity-type clauses are clearly distinguished from default-type clauses where the right to accelerate is conditioned upon the occurrence of a condition which is within the control of the debtor. Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580 (1976); In re Foreclosure of Sutton Invs., 46 N.C. App. 654, 266 S.E.2d 686 (1989).

Repeated Occasions for Performance. — Because an agreement between the parties did not call for repeated occasions for performance by either party, it did not establish a course of performance. GATX Logistics, Inc. v. Lowe's Cos., 143 N.C. App. 695, 548 S.E.2d 193, 2001 N.C. App. LEXIS 338 (2001).

§ 25-1-310. Subordinated obligations.

An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor. (1967, c. 562, s. 1; 2006-112, s. 1.)

OFFICIAL COMMENT

Source: Former Section 1-209.

Changes from former law: This section is substantively identical to former Section 1-209. The language in that section stating that it "shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it" has been deleted.

1. Billions of dollars of subordinated debt are held by the public and by institutional investors. Commonly, the subordinated debt is subordinated on issue or acquisition and is evidenced by an investment security or by a negotiable or non-negotiable note. Debt is also sometimes subordinated after it arises, either by agreement between the subordinating creditor and the debtor, by agreement between two creditors of the same debtor, or by agreement of all three parties. The subordinated creditor may be a stockholder or other "insider" interested in the common debtor; the subordinated debt may consist of accounts or other rights to payment not evidenced by any instrument. All such cases are included in the terms "subordinated obligation," "subordination," and "subordinated creditor."

2. Subordination agreements are enforceable between the parties as contracts; and in the bankruptcy of the common debtor dividends otherwise payable to the subordinated creditor are turned over to the superior creditor. This "turn-over" practice has on occasion been explained in terms of "equitable lien," "equitable assignment," or "constructive trust," but whatever the label the practice is essentially an equitable remedy and does not mean that there is a transaction "that creates a security interest in personal property. . . by contract" or a "sale of accounts, chattel paper, payment intangibles, or promissory notes" within the meaning of Section 9-109. On the other hand, nothing in this section prevents one creditor from assigning his rights to another creditor of the same

debtor in such a way as to create a security interest within Article 9, where the parties so intend.

3. The enforcement of subordination agreements is largely left to supplementary principles under Section 1-103. If the subordinated debt is evidenced by a certificated security, Section 8-202(a) authorizes enforcement against purchasers on terms stated or referred to on the security certificate. If the fact of subordination is noted on a negotiable instrument, a holder under Sections 3-302 and 3-306 is subject to the term because notice precludes him from taking free of the subordination. Sections 3-302(3)(a), 3-306, and 8-317 severely limit the rights of levying creditors of a subordinated creditor in such cases.

TABLES OF COMPARABLE SECTIONS FOR CHAPTER 25, REVISED ARTICLE 1

Former to Present

Editor's Note. — The following table shows G.S. sections from former Chapter 25, Article 1, and their comparable, new revised Chapter 25, Article 1 numbers. Where there is no comparable new number, the term "Omitted" has been inserted.

Former Section	Present Section
25-1-101	25-1-101
25-1-102	25-1-102, 25-1-103
25-1-102(3)	25-1-302
25-1-102(4)	25-1-302
25-1-102(5)	25-1-106
25-1-103	25-1-103
25-1-104	25-1-104
25-1-105	25-1-301
25-1-106	25-1-305
25-1-107	25-1-306
25-1-108	25-1-105
25-1-109	25-1-107
25-1-201	25-1-201
25-1-201(25), (27)	25-1-202
25-1-201(31)	25-1-206
25-1-201(37)	25-1-203
25-1-201(44)	25-1-204
25-1-202	25-1-307
25-1-203	25-1-304
25-1-204	25-1-205
25-1-204(1)	25-1-302
25-1-205	25-1-303
25-1-207	25-1-308
25-1-208	25-1-309
25-1-209	25-1-310

ARTICLE 2.

Sales.

NORTH CAROLINA COMMENT

Some generalizations about the sales article may prove helpful as an introduction before a part by part, section by section, analysis of the Code is undertaken.

The first apparent difference in approach made by the UCC (different from both the Uniform Sales Act and case-law approaches) is that the Code abandons the concept of "title" as the determinant of the rights of parties in a sales contract. See GS 25-2-401. Instead of the title concept, the Code substitutes a "transaction concept" and treats the rights of each party on an issue by issue basis. No preliminary elusive search for "title" is required as was necessary under the Uniform Sales Act and the prior law of North Carolina on sales. Questions as to who has the risk of loss, who may bring an action for price or whose creditors may reach the goods are answered directly by specific rules applicable to specific contracts and conduct of the parties. This is perhaps the most significant departure that the UCC makes from the prior sales law of which practitioners should be made aware.

A statute of frauds relating to the sale of goods will also be a significant addition to the sales law of North Carolina. G.S. 25-2-201 provides that contracts for the sale of goods involving more than $500 must be in writing. This will be the first statute of frauds relating to personal property to exist in North Carolina since 1792 when the State legislature repealed the seventeenth section of the English statute of frauds, 29 Charles II. The UCC, furthermore, introduces two other new ideas to North Carolina law, the doctrine of part performance and the provision that as between merchants a writing in confirmation of a contract, sufficient as against the sender, will be good as against the recipient as a memorandum of the contract if the recipient fails to object in writing to its contents. This latter innovation also evidences another significant variation in sales law found in the Code; businessmen (called "merchants" in the Code) are held to more business-like standards than nonbusinessmen in certain instances. "Merchants" are held to a higher standard of sophistication than are nonmerchants because they are "professionals."

Another distinctive UCC approach is that sales contracts for the sale of goods should have their own special rules. Rules for the formation of a sales contract are codified in the Code and reliance cannot be placed on general principles of the laws of contracts. The specific rules applicable to sales contracts as set out in the Code govern. For instance, the Code makes the seal obsolete and inoperative as importing consideration for a contract; the Code tends to liberalize and to enforce contracts which may be indefinite to some degree in terms of time for performance, place for delivery, price, or time for payment, by the application of external, objective reasonable standards relied on in the business community or because of prior dealings and trade usages; "firm offers" are made binding and irrevocable, even if made without consideration "between merchants" (see GS 25-2-205). Modifications of contracts may be made without consideration and this rule too is contrary to the common law (GS 25-2-209).

On the subject of "warranties," the Code is generally in accord with prior North Carolina law. An exception to this is the provision of GS 25-2-317 making warranties, both express and implied, cumulative if consistent. GS 25-2-317 apparently changes the prior North Carolina rule that if there was an express warranty in a sales contract, there could be no coexisting implied warranty on the same subject. In addition, the Code relaxes the requirement of privity in warranty actions by extending warranty coverage to buyers' families, households, and guests who might be injured by reason of a breach of warranty with reference to goods used or consumed. The requirement of privity which disables remote consumers from suing remote sellers or manufacturers for breach of warranty is unchanged.

Another area in which North Carolina's law is materially changed is with respect to goods obtained by a purchaser who gives a "bad check." Under prior law, a purchaser who gave a worthless check for goods got "no" title; he could not pass title to the goods even to a bona fide purchaser. Under the Code (GS 25-2-403), a purchaser who procures goods by passing a "bad check" obtains at least a "voidable" title and can transfer good title to a bona fide purchaser for value at any time before his title is avoided by the seller. The statute of limitations is changed to four years for all actions arising out of breach of contracts for sales of goods. This, of course, changes the limitation of time within which actions on simple contracts and actions on sealed contracts must be brought, making the statute of limitations uniform as to all sales contracts, thus materially changing North Carolina law in this respect.

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PART 1.

SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER.

§ 25-2-101. Short title.

This article shall be known and may be cited as Uniform Commercial Code — Sales. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

This Article is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present Article is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present Article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

NORTH CAROLINA COMMENT

This article is entirely new. The Uniform Sales Act, although adopted and in effect in thirty-six states and the District of Columbia, was never adopted in North Carolina.

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For note on "Products Liability — Sales Warranties of the Uniform Commercial Code," see 46 N.C.L. Rev. 451 (1968).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For survey of 1982 commercial law, see 61 N.C.L. Rev. 1018 (1983).

For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see N.C.L. Rev. 1156 (1987).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Applied in Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991).

Cited in Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988); Sunamerica Fin. Corp. v. Bonham, 328 N.C. 254, 400 S.E.2d 435 (1991); United States v. 328 Pounds, More Or Less, Of Wild Am. Ginseng, 347 F. Supp. 2d 241, 2004 U.S. Dist. LEXIS 24926 (W.D.N.C.

2004); Riddle Farm Equip., Inc. v. Boles (In re Boles), — Bankr. —, 2004 Bankr. LEXIS 2384 (Bankr. M.D.N.C. Oct. 26, 2004).

§ 25-2-102. Scope; certain security and other transactions excluded from this article.

Unless the context otherwise requires, this article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 75, Uniform Sales Act.

Changes: Section 75 has been rephrased.

Purposes of Changes and New Matter: To make it clear that:

The Article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Security transaction" is used in the same sense as in the Article on Secured Transactions (Article 9).

Cross Reference:
Article 9.

Definitional Cross References:
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Present sale". Section 2-106.
"Sale". Section 2-106.

NORTH CAROLINA COMMENT

This section sets out the scope of the Code, limiting it to transactions in goods (as defined in GS 25-2-105) and indicates that the article on sales does not apply to transactions intended as security even though in the form of an unconditional contract of sale or to sell. The section also makes clear that the sales article does not impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

Legal Periodicals. — For survey of 1974 case law on the applicability of the Uniform Commercial Code to the sale of a business, see 53 N.C.L. Rev. 1097 (1975).

For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Article Not Applicable to True Lease. — Automobile lease agreement with an option to purchase at fair market value at the termination of the lease was a true lease, and not a future sale, and Article 2 was not applicable thereto. Alpiser v. Eagle Pontiac-GMC-Isuzu, Inc., 97 N.C. App. 610, 389 S.E.2d 293 (1990).

A transaction involving a sale of a tractor in consideration of payments of money and delivery of haulage services by the plaintiff is a sale of goods within the purview of this section. Owens v. Harnett Transf., Inc., 42 N.C. App. 532, 257 S.E.2d 136 (1979).

Because the sale of a mobile home is a "transaction in goods," it is subject to Article 2 of North Carolina's version of the Uniform Commercial Code. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Sale of pharmaceutical drugs is governed by the North Carolina Uniform Commercial Code. IWTMM, Inc. v. Forest Hills Rest Home, 156 N.C. App. 556, 577 S.E.2d 175, 2003 N.C. App. LEXIS 195 (2003).

Mixed Contracts. — Contract which a buyer and a seller concluded for the purchase of a mobile home was governed by North Carolina's Uniform Commercial Code because the predominant factor of the contract was the delivery of the mobile home, and services provided to install it were incidental, and the trial court ruled correctly that the buyer and seller's contract reduced the time for filing an action for breach of contract from four years to one year, pursuant to G.S. 25-2-725(1), and that the buyer's action against the seller was time-barred. Hensley v. Ray's Motor Co. of Forest City, Inc., 158 N.C. App. 261, 580 S.E.2d 721, 2003 N.C. App. LEXIS 1050 (2003).

New Tractor Is a Good. — UCC art. 2, enacted in North Carolina as G.S. 25-2-101 et seq., was controlling in a case where a seller sold and delivered a new tractor to a buyer, but the seller claimed that title to the tractor never passed from the seller to the buyer, because the transaction was a transaction involving a good. Riddle Farm Equip., Inc. v. Boles (In re Boles), — Bankr. —, 2004 Bankr. LEXIS 2384 (Bankr. M.D.N.C. Oct. 26, 2004).

Applied in HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974); North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978).

Cited in Bank of Alamance v. Isley, 74 N.C. App. 489, 328 S.E.2d 867 (1985); Haywood Street Redevelopment Corp. v. Harry S. Peterson, Co., 120 N.C. App. 832, 463 S.E.2d 564 (1995); In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-103. Definitions and index of definitions.

(1) In this article unless the context otherwise requires

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) Repealed by Session Laws 2006-112, s. 2, effective October 1, 2006.

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods. Any manufacturer of self-propelled motor vehicles, as defined in G.S. 20-4.01, is also a "seller" with respect to buyers of its product to whom it makes an express warranty, notwithstanding any lack of privity between them, for purposes of all rights and remedies available to buyers under this Article.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"Acceptance." G.S. 25-2-606.
"Banker's credit." G.S. 25-2-325.
"Between merchants." G.S. 25-2-104.
"Cancellation." G.S. 25-2-106 (4).
"Commercial unit." G.S. 25-2-105.
"Confirmed credit." G.S. 25-2-325.
"Conforming to contract." G.S. 25-2-106.
"Contract for sale." G.S. 25-2-106.
"Cover." G.S. 25-2-712.
"Entrusting." G.S. 25-2-403.
"Financing agency." G.S. 25-2-104.
"Future goods." G.S. 25-2-105.
"Goods." G.S. 25-2-105.
"Identification." G.S. 25-2-501.
"Installment contract." G.S. 25-2-612.
"Letter of credit." G.S. 25-2-325.
"Lot." G.S. 25-2-105.
"Merchant." G.S. 25-2-104.
"Overseas." G.S. 25-2-323.
"Person in position of seller." G.S. 25-2-707.
"Present sale." G.S. 25-2-106.
"Sale." G.S. 25-2-106.
"Sale on approval." G.S. 25-2-326.
"Sale or return." G.S. 25-2-326.
"Termination." G.S. 25-2-106.

(3) "Control" as provided in G.S. 25-7-106 and the following definitions in other Articles apply to this Article:

"Check"	G.S. 25-3-104.
"Consignee"	G.S. 25-7-102.
"Consignor"	G.S. 25-7-102.
"Consumer Goods"	G.S. 25-9-102.
"Dishonor"	G.S. 25-3-502.
"Draft"	G.S. 25-3-104.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1; 1983, c. 598; 2000-169, s. 8; 2006-112, ss. 2, 27.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
Subsection (1): Section 76, Uniform Sales Act.

Changes:

The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior Act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of Changes and New Matter:

1. The phrase "any legal successor in interest of such person" has been eliminated since Section 2-210 of this Article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross References:

Point 1: See Section 2-210 and Comment thereon.

Point 2: Section 1-201.

Definitional Cross References:

"Person". Section 1-201.

NORTH CAROLINA COMMENT

There appears to be no specific change in prior North Carolina law attributable to this section. There were, however, no statutes related to this section and the cases do not expressly define the terms treated here. They are expressly and explicitly defined in the Code because of the UCC's general concern for the precise use of language in cross references.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 2 and 27, effective October 1, 2006, repealed subdivision (1)(b) and in subsection (3), added "'Control' as provided in G.S. 25-7-106 and" at the beginning of the introductory paragraph and made minor stylistic changes throughout the subsection.

Legal Periodicals. — For article, "North

Carolina's New Products Liability Act: A Critical Analysis," see 16 Wake Forest L. Rev. 171 (1980).

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

Right to assign legal rights is not exclusively governed by the UCC. Even if a party technically is not a "buyer" under the UCC, as long as it has a valid claim for breach of contract against defendant, the common law will permit its assignment. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity Not Defined. — North Carolina's Uniform Commercial Code does not define "privity" and there are no governing Code provisions dispositive of this issue. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Evidence of Good Faith Required by § 20-305 Held Sufficient. — Where manufacturer gave dealer at least a year's notice concerning the likelihood of cancellation, manufacturer treated dealer no differently than it did any of its other heavy-duty truck franchisees; and more importantly, where there was no evidence of dishonesty by manufacturer, the record was replete with evidence of manufacturer's good faith in cancelling its heavy-duty truck franchises with dealer under G.S. 20-305. Carolina Truck & Body Co. v. GMC, 102 N.C. App. 262, 402 S.E.2d 135, cert. denied, 329 N.C. 266, 407 S.E.2d 831 (1991).

Manufacturer's withdrawal from the heavy duty truck market was in good faith as required by G.S. 20-305(6). Good faith is defined in G.S. 20-286(8b) as honest in fact and the observation of reasonable commercial standards of fair dealing in the trade as defined and interpreted in this section. Carolina Truck & Body Co. v. GMC, 102 N.C. App. 262, 402 S.E.2d 135, cert. denied, 329 N.C. 266, 407 S.E.2d 831 (1991).

Honesty in Fact Required of Supplier. — A good faith duty requiring a supplier of products to disclose its internal strategies to distributors was inappropriate, as the breadth of good faith required was limited to the "honesty in fact" definition of G.S. 25-1-201, which governed distributor's claim under G.S. 25-1-203, rather than the more expansive "reasonable commercial standards of fair dealing in the trade" definition of this section. L.C. Williams Oil Co. v. Exxon Corp., 625 F. Supp. 477 (M.D.N.C. 1985).

Manufacturers of products other than self-propelled motor vehicles who are not in a direct contractual relationship with ultimate purchasers are, by implication, not "sellers" against whom purchasers may revoke acceptance. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Good Faith Obligation Not Breached. — Apparel company did not breach its obligation of good faith in the performance of its contract with an apparel assembler where (1) there was no evidence to support the assembler's claim that the company failed to provide it with sufficient cut parts under the contract, rather, the evidence showed that, despite having sufficient cut parts, the assembler often failed to meet the contract production levels, (2) the company did not induce the assembler to invest in T-shirt manufacturing machinery or to rely on alleged promises of continued work as the parties did not negotiate a new agreement regarding T-shirt production, and (3) the company did not unlawfully conceal the fact that it was building its own shirt manufacturing capability with the intent of terminating its relationship with the assembler as the parties' contract stated that the assembler was not the company's sole supplier, the contract gave the company the power to determine the assembler's quantities and to terminate their relationship, and the company did not have any obligation to disclose its future plans to the assembler. Sara Lee Corp. v. Quality Mfg., 201 F. Supp. 2d 608, 2002 U.S. Dist. LEXIS 27687 (M.D.N.C. 2002).

Applied in Superior Foods, Inc. v. Harris-Teeter Super Mkts., Inc., 288 N.C. 213, 217 S.E.2d 566 (1975); Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282 (1979); Branch Banking & Trust Co. v. Creasy, 44 N.C. App. 289, 260 S.E.2d 782 (1979); Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991); Crews v. W.A. Brown & Son, 106 N.C. App. 324, 416 S.E.2d 924 (1992).

Cited in B.B. Walker Co. v. Ashland Chem. Co., 474 F. Supp. 651 (M.D.N.C. 1979); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Halprin v. Ford Motor Co., 107 N.C. App. 423, 420 S.E.2d 686 (1992); McCorkle v. Aeroglide Corp., 115 N.C. App. 651, 446 S.E.2d 145 (1994); Sale Chevrolet, Buick, BMW, Inc. v. Peterbilt of Florence, Inc., 133 N.C. App. 177, 514 S.E.2d 747 (1999).

§ 25-2-104. Definitions: "Merchant"; "between merchants"; "financing agency."

(1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany or are associated with the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (G.S. 25-2-707).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants. (1965, c. 700, s. 1; 2006-112, s. 28.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None. But see Sections 15(2), (5), 16(c), 45(2) and 71, Uniform Sales Act, and Sections 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this Article.

Purposes:

1. This Article assumes that transaction between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of expressly stating rules applicable "between merchants" and "as against a merchant" wherever they are needed instead of making them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants."

2. The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this Article and they are of three kinds. Sections 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant" under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . . ." since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be "merchants." But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in Section 2-314 on the warranty of merchantability, such warranty is implied only "if the seller is a merchant with respect to goods of that kind." Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in Section 2-402(2) for retention of possession by a merchant-seller falls in the same class; as does Section 2-403(2) on entrusting of possession to a merchant "who deals in goods of that kind".

A third group of sections includes 2-103(1)(b), which provides that in the case of a merchant "good faith" includes observance of reasonable commercial standards of fair dealing in the trade; 2-327(1)(c), 2-603 and 2-605, dealing with responsibilities of merchant buyers to follow seller's instructions, etc.; 2-509 on risk of loss, and 2-609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the "practices" or the "goods" aspect of the definition of merchant.

3. The "or to whom such knowledge or skill may be attributed by his employment of an agent or broker . . ." clause of the definition of merchant means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

Cross References:

Point 1: See Sections 1-102 and 1-203.

Point 2: See Sections 2-314, 2-315 and 2-320 to 2-325, of this Article, and Article 9.

Definitional Cross References:

"Bank". Section 1-201.
"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Document of title". Section 1-201.
"Draft". Section 3-104.
"Goods". Section 2-105.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsections (1) and (3): One of the unique features of the sales article of the Code finds its genesis in this section. At various points in the Code different standards are applied to "merchants" as opposed to "nonmerchant" buyers and sellers. (See, e.g., inter alia, GS 25-2-201, which provides a special exception to the statute of frauds applicable only to "merchants" wherein a merchant is held liable in contract of sale or to sell upon his receipt of a memorandum and his failure to object to its terms. Also note that GS 25-2-205, which relates to firm offers made without consideration, applies only to "merchants." GS 25-2-207 sets out special provisions as to the effect of the inclusion of additional or different terms to a contract in an acceptance "between merchants." GS 25-2-209 (2) establishes special rules as to limitations or modifications of contracts between "merchants" and "nonmerchants." See also GS 25-2-603, imposing special duties on a "merchant buyer" who has rightfully rejected goods sent by seller, and GS 25-2-605 (1) (b), where merchant seller may request written specification of defects upon which a rejection is based if the buyer is also a merchant. See also GS 25-2-314, relating to the implied warranty of merchantability which under the UCC applies only when the sale is by a seller who is a "merchant.")

The distinctions between "merchants" and "nonmerchants" and as to contracts "between merchants" are new to North Carolina law and result in significant differences of treatment resulting in significant changes in North Carolina law in distinguishing legal relations created between those who are essentially "professionals" and those who are not.

Subsection (2), defining "financing agency," is new in North Carolina law.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 28, effective October 1, 2006, inserted "or are associated with" in the first sentence of subsection (2).

Legal Periodicals. — For survey of 1976 case law on commercial law, see 55 N.C.L. Rev. 943 (1977).

For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For note on farmers as merchants under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

CASE NOTES

Whether a person is a merchant is a question of law. Cudahy Foods Co. v. Holloway, 55 N.C. App. 626, 286 S.E.2d 606 (1982).

Focus in Determining Who Is Merchant. — The mere fact that one is "in business" does not, without more, give rise to the conclusive presumption that by his occupation, the businessman holds himself out as having knowledge peculiar to the practices involved in the transaction. The focus remains on the occupation or type of business as it relates to the subject matter of the transaction. Cudahy Foods Co. v. Holloway, 55 N.C. App. 626, 286 S.E.2d 606 (1982).

Whether Farmer Is "Merchant" Is Matter for Proof. — Since the growing and marketing of corn and soybeans is an important part of the agricultural economy of the area, and the procedures for marketing these crops are well known, it cannot be said that a particular farmer or grower is not a "merchant" within the code definition; rather, this is a matter for proof. Currituck Grain, Inc. v. Powell, 28 N.C. App. 563, 222 S.E.2d 1 (1976).

Evidence Sufficient to Support Finding That Farmer Was "Merchant". — The evidence that the defendant was a farmer raising corn and soybeans was sufficient to support a jury's finding that the defendant by his occupation held himself out as having knowledge or skill peculiar to corn and soybeans. This would put him within the statutory definition of merchant. There also was sufficient evidence to support a jury's finding that the defendant by his occupation held himself out as having knowledge or skill peculiar to the practice of dealing in corn and soybeans which would also put him within the statutory definition of merchant. Currituck Grain, Inc. v. Powell, 38 N.C. App. 7, 246 S.E.2d 853 (1978).

Vehicle Dealerships as Merchants. — A dealership that sold a used car and a second dealership that accepted it in trade from the purchaser were merchants charged with having knowledge or skill peculiar to the practices of their business transactions and were held to a higher standard of sophistication than nonmerchants because they were professionals. Sale Chevrolet, Buick, BMW, Inc. v. Peterbilt of Florence, Inc., 133 N.C. App. 177, 514 S.E.2d 747 (1999).

Isolated Purchase Unrelated to Buyer's Business. — The familiarity with trade customs test is not so broad as to extend to the isolated purchase of a type of goods unrelated and unnecessary to the business or occupation of the buyer. Cudahy Foods Co. v. Holloway, 55 N.C. App. 626, 286 S.E.2d 606 (1982).

Applied in Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975); Coffer v. Standard Brands, Inc., 30 N.C. App. 134, 226 S.E.2d 534 (1976); Batiste v. American Home Prods. Corp., 32 N.C. App. 1, 231 S.E.2d 269 (1977); Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344 (1979); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980); Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991).

Cited in Preston v. Thompson, 53 N.C. App. 290, 280 S.E.2d 780 (1981); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990); Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992); Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998); Greene v. GMC, 261 F. Supp. 2d 414, 2003 U.S. Dist. LEXIS 7313 (W.D.N.C. 2003).

§ 25-2-105. Definitions: "Transferability"; "goods"; "future" goods; "lot"; "commercial unit."

(1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (G.S. 25-2-107).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by

number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsections (1), (2), (3) and (4)—Sections 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6)—none.

Changes: Rewritten.

Purposes of Changes and New Matter:

1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that:

The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this Article. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this Article.

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals, or structures to be removed from the land Section 2-107(1) (Goods to be severed from realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This Article in including within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale.

"Investment securities" are expressly excluded from the coverage of this Article. It is not intended by this exclusion, however, to prevent the application of a particular section of this Article by analogy to securities (as was done with the Original Sales Act in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of Section 2—501 and all that this section says is what kinds of goods may be the subject of a sale.

Cross References:

Point 1: Sections 2-107, 2-201, 2-501 and Article 8.

Point 5: Section 2-501.

See also Section 1-201.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Fungible". Section 1-201.
"Money". Section 1-201.

"Present sale". Section 2-106.
"Sale". Section 2-106.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1), defining "goods," accords with North Carolina cases. See Vaughan v. Town of Murfreesboro, 96 N.C. 317, 2 S.E. 676 (1887); Pippin v. Ellison, 34 N.C. 61 (1851), distinguishing "goods" from choses in action but making the term embrace not only tangible inanimate property such as furniture, farming utensils, corn, etc., but also slaves, horses, cattle, hogs, etc. Growing crops can also be dealt with as personalty. See Odom v. Clark, 146 N.C. 544, 60 S.E. 513 (1908). Unborn animals are likewise the subject of sales as "goods." See Fonville v. Casey, 5 N.C. 389 (1810).

Subsection (2) accords with DeVane v. Fennell, 24 N.C. 36 (1841), and Heiser v. Mears, 120 N.C. 443, 27 S.E. 117 (1897), that no interest passes in goods until in existence and identified, and pending their existence or identification, a contract relating to their sale is only a contract "to sell."

Subsection (3) accords with prior North Carolina law that there may be a sale of a part interest in an identified chattel. See Bullman v. Edney, 232 N.C. 465, 61 S.E.2d 338 (1950), creating a tenancy in common in personalty.

Subsection (4) changes the law in North Carolina. See the case of Waldo v. Belcher, 33 N.C. 609 (1850), which held that a sale of 2800 of 3100 bushels of stored corn did not pass title because not sufficiently identified to the contract. The UCC provision accords with G.S. 6 (1) of the Uniform Sales Act and follows what is known as the "American Rule" as to the sale of fungible goods.

Subsections (5) and (6) have no statutory or decisional parallel in North Carolina law.

Legal Periodicals. — For note discussing liquidated damages, specific performance and other remedies for breach of cotton sales contracts, see 53 N.C.L. Rev. 579 (1974).

For survey of 1974 case law on the applicability of the Uniform Commercial Code to the sale of a business, see 53 N.C.L. Rev. 1097 (1975).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

For casenote: "Brevorka v. Wolfe Construction, Inc.: Did I Just Waive My Rights to the Implied Warranty of Workmanlike Construction?," see 26 N.C. Cent. L.J. 59 (2003).

CASE NOTES

The term "goods" includes an automobile within the meaning of this section. Gillespie v. AMC, 51 N.C. App. 535, 277 S.E.2d 100 (1981).

New Tractor Is a Good. — UCC art. 2, enacted in North Carolina as G.S. 25-2-101 et seq., was controlling in a case where a seller sold and delivered a new tractor to a buyer, but the seller claimed that title to the tractor never passed from the seller to the buyer, because the transaction was a transaction involving a good. Riddle Farm Equip., Inc. v. Boles (In re Boles), — Bankr. —, 2004 Bankr. LEXIS 2384 (Bankr. M.D.N.C. Oct. 26, 2004).

But Not Real Estate. — Real estate does not fall under the definition of "goods." Cudahy Foods Co. v. Holloway, 55 N.C. App. 626, 286 S.E.2d 606 (1982).

Mobile Home. — Contract which a buyer and a seller concluded for the purchase of a mobile home was governed by North Carolina's Uniform Commercial Code because the predominant factor of the contract was the delivery of the mobile home, and services provided to install it were incidental, and the trial court ruled correctly that the buyer and seller's contract reduced the time for filing an action for breach of contract from four years to one year, pursuant to G.S. 25-2-725(1), and that the buyer's action against the seller was time-barred. Hensley v. Ray's Motor Co. of Forest City, Inc., 158 N.C. App. 261, 580 S.E.2d 721, 2003 N.C. App. LEXIS 1050 (2003).

Sale of spinal scanner was sale of goods; thus, sales transaction was governed by UCC. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

The sale of potable water constituted a sale of goods under this article. Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

Medical professionals do not engage in the sale of "goods" when they either issue a prescription for a drug or prepare and fit dentures. Inherent in the legislation is the recognition that the essence of the transaction between the retail seller and the consumer relates to the article sold, and that the seller is in the business of supplying the product to the consumer. It is the product and that alone for which he is paid. The physician offers his professional services and skill. It is the professional services and his skill for which he is paid, and they are the essence of the relationship between him and his patient. Cameron v. New Hanover Mem. Hosp., 58 N.C. App. 414, 293 S.E.2d 901, cert. denied and appeal dismissed, 307 N.C. 127, 297 S.E.2d 399 (1982).

Sale of pharmaceutical drugs is governed by the North Carolina Uniform Commercial Code. IWTMM, Inc. v. Forest Hills Rest Home, 156 N.C. App. 556, 577 S.E.2d 175, 2003 N.C. App. LEXIS 195 (2003).

Applied in Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975).

Cited in HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974); Currituck Grain, Inc. v. Powell, 28 N.C. App. 563, 222 S.E.2d 1 (1976); Preston v. Thompson, 53 N.C. App. 290, 280 S.E.2d 780 (1981); Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986); Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990); Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990); Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994); First Atl. Mgt. Corp. v. Dunlea Realty Co., 131 N.C. App. 242, 507 S.E.2d 56 (1998); Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998); United States v. 328 Pounds, More Or Less, Of Wild Am. Ginseng, 347 F. Supp. 2d 241, 2004 U.S. Dist. LEXIS 24926 (W.D.N.C. 2004).

§ 25-2-106. Definitions: "Contract"; "agreement"; "contract for sale"; "sale"; "present sale"; "layaway contract"; "conforming" to contract; "termination"; "cancellation."

(1) In this article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods, including layaway contracts. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (G.S. 25-2-401). A "present sale" means a sale which is accomplished by the making of the contract. A "layaway contract" means any contract for the sale of goods in which the seller agrees with the purchaser, in consideration for the purchaser's payment of a deposit, down payment, or similar initial payment, to hold identified goods for future delivery upon the purchaser's payment of a specified additional amount, whether in installments or otherwise.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance. (1965, c. 700, s. 1; 1967, c. 24, s. 6; 1993, c. 340, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1)—Section 1 (1) and (2), Uniform Sales Act; Subsection (2)—none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4)—none.

Changes: Completely rewritten.

Purposes of Changes and New Matter:

1. Subsection (1): "Contract for sale" is used as a general concept throughout this Article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the Article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or delivery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this Article between termination and cancellation.

Cross References:

Point 2: Sections 1-203, 1-205, 2-208 and 2-508.

Definitional Cross References:

"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Remedy". Section 1-201.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

No significant change in North Carolina law is perceived as a result of this section which serves mainly to fill out the general aims of the Code to provide a self-sufficient statement of the law of sales.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

CASE NOTES

Existence of Warranties as Showing Standard for Conformity. — The existence of any express or implied warranties would be relevant to show the standard to which the goods were supposed to conform. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979).

Lease Held Not a Future Sale. — Automobile lease agreement with an option to purchase at fair market value at the termination of the lease was a true lease, and not a future sale, and Article 2 was not applicable thereto. Alpiser v. Eagle Pontiac-GMC-Isuzu, Inc., 97 N.C. App. 610, 389 S.E.2d 293 (1990).

Applied in Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972); Superior Foods, Inc. v. Harris-Teeter Super Mkts., Inc., 288 N.C. 213, 217 S.E.2d 566 (1975); Batiste v. American Home Prods. Corp., 32 N.C. App. 1, 231 S.E.2d 269 (1977); North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978); Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983).

Cited in United Roasters, Inc. v. Colgate-Palmolive Co., 485 F. Supp. 1041 (E.D.N.C. 1979); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Smith v. Cessna Aircraft Co., 571 F. Supp. 433 (M.D.N.C. 1983); Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986); Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986); Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990); Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

§ 25-2-107. Goods to be severed from realty; recording.

(1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm

thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third-party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale. (1965, c. 700, s. 1; 1975, c. 862, s. 4.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Section 76, Uniform Sales Act on prior policy; Section 7, Uniform Conditional Sales Act.

Purposes:

1. Subsection (1). Notice that this subsection applies only if the minerals or structures "are to be severed by the seller". If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the Statute of Frauds and of the recording of land rights apply to them. Therefore, the Statute of Frauds section of this Article does not apply to such contracts though they must conform to the Statute of Frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this Article regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in subsection (3) for recording such contracts is within the purview of this Article since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the Article on Secured Transactions (Article 9) and it is to be noted that the definition of goods in that Article differs from the definition of goods in this Article.

However, both Articles treat as goods growing crops and also timber to be cut under a contract of severance.

Cross References:

Point 1: Section 2-201.
Point 2: Section 2-105.
Point 3: Articles 9 and 9-105.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Party". Section 1-201.
"Present sale". Section 2-106.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law that if a seller is to sever articles from the realty pursuant to a contract of sale, the contract is for a sale of personalty. See Walston v. Lowry, 212 N.C. 23, 192 S.E. 877 (1937), where it is held that a contract whereby the seller contracts to sell timber, to be cut by the seller, is a contract to sell personalty and not a contract to sell realty requiring a writing. In addition, North Carolina went further than this UCC subsection and held that even if the contract specifies that the buyer is to make the severance of articles attached to the realty from the seller's land, such is a contract for the sale of personalty and not a contract for the sale of realty and need not be in writing as required under the statute of frauds relating to contracts for the sale of realty (GS 22-2). See Bishop v. DuBose, 252 N.C. 158, 113 S.E.2d 309 (1960). If the contract does not contemplate the passage of title until after severance, it is a contract for the sale of personalty irrespective of who is to make the severance. Johnson v. Wallin, 227 N.C. 669, 44 S.E.2d 83 (1947); Ives v. Atlantic & N.C.R.R., 142 N.C. 131, 55 S.E. 74 (1906).

Subsection (2) accords in principle with Flynt v. Conrad, 61 N.C. 190 (1867), that a growing crop is a personal chattel and can be transferred or reserved by parol contract because it is personalty. Other items affixed to real property which can be removed without injury to the realty are treated as goods by this subsection of the UCC even though attached at the time the contract is made and without regard to which party (buyer or seller) is to make the severance. This latter aspect of subsection (2) would appear to conflict with prior North Carolina law that if an item is affixed to the land, it is presumed to be a part of the realty to which attached and in order to create a binding contract to sell such item, there must be a writing as required for contracts for the sale of realty. See Stephens v. Carter, 246 N.C. 318, 98 S.E.2d 311 (1957).

Whether an item is to be deemed "real" or "personal" property ("goods") will be determined under the Code by its potential for severability without injury to the realty to which it is attached and not upon the more difficult determination of whether the item is a "fixture."

It is interesting to note that in North Carolina the net effect of subsections (1) and (2) will be that while certain contracts will be rendered "sales of goods" that were considered "sales of realty" (see Stephens v. Carter, 246 N.C. 318, 98 S.E.2d 311 (1957)), with the adoption of the UCC, GS 25-2-201, establishing a statute of frauds for the sale of goods for more than $500, more contracts will have to be in writing notwithstanding that many contracts formerly held to be sales of realty shall have become sales of "goods."

Subsection (3) provides for recording a contract contemplating severance of items attached to realty, such recordation to be upon the real property recordation books, whether or not there will be material injury to the realty. This provision is new to North Carolina law and serves to preserve the rights of a buyer of an item attached to realty (which is to be severed) from the claims of purchasers of the realty and lien creditors of the owner-seller.

Legal Periodicals. — Application of the Uniform Commercial Code to Option Contracts for the Sale of Goods, and Implying Promises to Find Sufficient Consideration: Why and How the North Carolina Supreme Court Got It Wrong in Fordham v. Eason, 23 Campbell L. Rev. 49 (2000).

For casenote: "Brevorka v. Wolfe Construction, Inc.: Did I Just Waive My Rights to the Implied Warranty of Workmanlike Construction?," see 26 N.C. Cent. L.J. 59 (2003).

CASE NOTES

Contracts for the sale of timber to be cut are governed by Article 2 of the UCC pursuant to subsection (2) of this section; accordingly, the controlling statute is G.S. 25-2-725(1), which provides for a four year period of limitation, and not the three year statute of limitations in G.S. 1-52. Mills v. New River Wood Corp., 77 N.C. App. 576, 335 S.E.2d 759 (1985).

Trespass to Chattel. — A dispute over a trespass to timber where the claim of a possessory interest arises under a contract for sale of timber should be settled using a trespass to chattel analysis because such timber is classified as goods under North Carolina law. Fordham v. Eason, 351 N.C. 151, 521 S.E.2d 701 (1999).

Where, under the Uniform Commercial Code, defendants/loggers had a valid contract for the sale of timber when plaintiff/logger, who held only an option to purchase and had given no consideration to finalize the contract, entered and removed the timber from defendant/owners' land, said removal was unauthorized and resulted in a trespass to chattel. Fordham v. Eason, 351 N.C. 151, 521 S.E.2d 701 (1999).

Cited in Fisher v. Elmore, 610 F. Supp. 123 (E.D.N.C. 1985); Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

PART 2.

FORM, FORMATION AND READJUSTMENT OF CONTRACT.

§ 25-2-201. Formal requirements; statute of frauds.

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of five hundred dollars ($500.00) or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within ten days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (G.S. 25-2-606). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

Changes: Completely re-phrased; restricted to sale of goods. See also Sections 1-206, 8-319 and 9-203.

Purposes of changes: The changed phraseology of this section is intended to make it clear that:

1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It may be written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted.

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment therefor, the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Cross References:

See Sections 1-201, 2-202, 2-207, 2-209 and 2-304.

Definitional Cross References:

"Action". Section 1-201.
"Between merchants". Section 2-104.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Notice". Section 1-201.
"Party". Section 1-201.
"Reasonable time". Section 1-204.
"Sale". Section 2-106.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

The statute of frauds relating to the sale of goods, while at one time in effect in North Carolina, has not been in force in this State since 1792. See Odom v. Clark, 146 N.C. 544, 60 S.E. 513 (1908). This entire section is new to the law of North Carolina.

North Carolina, however, does have the statute of frauds as it relates to real property transactions. The statute of frauds provision of the UCC, therefore, will be considered in the context of North Carolina's current decisions relating to the statute of frauds:

The second sentence of subsection (1) of GS 25-2-201 provides that a writing is not insufficient to satisfy the statute of frauds because it omits or incorrectly states a term; but that a contract is not enforceable beyond the quantity of goods shown in writing if terms are omitted in the contract. North Carolina law provides in the statute of frauds cases that a memorandum of contract to satisfy the statute must embody the terms of the contract, the names of the vendor and vendee, a description of the property to be transferred and that it should be signed by the party to be charged therewith or by someone lawfully authorized by the party to be charged. The essential terms of the contract, the price and a description of the property to be transferred must be in the contract. See Harvey v. Linker, 226 N.C. 711, 40 S.E.2d 202 (1946); Hall v. Misenheimer, 137 N.C. 183, 49 S.E. 104 (1904); Shepherd v. Duke Power Co., 140 F. Supp. 27 (M.D.N.C. 1926). But see, even in North Carolina, the cases of Bateman v. Hopkins, 157 N.C. 470, 73 S.E. 133 (1911), and Mizell v. Burnett, 49 N.C. 249 (1857), which hold that if the action is against the *vendor* on a contract to sell land, it is not required for the validity of the contract that the consideration appear in the writing and parol evidence is admissible to show the purchase price.

This UCC provision, while requiring a memorandum and while requiring application of the statute of frauds to sales of personalty, lessens the rigid requirements of the statute of frauds in effect in North Carolina as now applied to realty, which requires that every essential term of a contract must be in the memorandum before it will be enforced. A memorandum that will satisfy the statute of frauds requirement under this section need only (1) contain a writing sufficient to indicate a contract of sale between the parties; (2) be signed by the parties or by authorized agents; and (3) state a quantity. The quantity term is the "heart" of the contract. The other terms such as price (GS 25-2-305), place of delivery (GS 25-2-308) and time of delivery (GS 25-2-309) will be supplied by this article if omitted in the memorandum of contract. In addition, these terms can apparently be supplied by parol. Prior North Carolina law applicable to the statute of frauds will be materially changed.

Subsection (2) is entirely new and has no parallel in prior North Carolina law. Note that subsection (2) applies "between merchants" only.

Subsection (3)(a) recognizes the doctrine of part performance as taking a contract out of the statute of frauds provision. North Carolina did not recognize that partial performance would take a contract otherwise required to be in writing outside of the statute of frauds. Hall v. Misenheimer, 137 N.C. 183, 49 S.E. 104 (1904); Ebert v. Disher, 216 N.C. 36, 3 S.E.2d 301 (1939); Grantham v. Grantham, 205 N.C. 363, 171 S.E. 331 (1933).

Since North Carolina did not have a statute of frauds as to contracts for the sale of personal property, the same results as were reached will be reached under this UCC provision, subsection (3)(a), requiring a writing but obviating the necessity for a writing where partial performance as set out in subsection (3)(a) is present.

Subsection (3)(b) accords with Sandlin v. Kearney, 154 N.C. 596, 70 S.E. 942 (1911), that the admissions of the parties in their pleadings may stand for the writing required by the statute of frauds.

Subsection (3)(c) would seem to accord with prior North Carolina law that the statute of frauds applies only to executory contracts and not to executed contracts. See Sprinkle v. Ponder, 233 N.C. 312, 64 S.E.2d 171 (1951); Willis v. Willis, 242 N.C. 597, 89 S.E.2d 152 (1955); Keith Bros. v. Kennedy, 194 N.C. 784, 140 S.E. 721 (1927). But note that this UCC section makes the contract enforceable only with respect to goods for which payment has been made and accepted or which have been received and accepted in the absence of a writing.

Legal Periodicals. — For article on statute of frauds as to personal property under the Uniform Commercial Code, see 4 Wake Forest Intra. L. Rev. 41 (1968).

For note on farmers as merchants under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "The Regulation of Contractual Change: A Guide to No Oral Modification Clauses for North Carolina Lawyers," see 81 N.C.L. Rev. 2239 (2003).

CASE NOTES

This section applies only to executory contracts and not to executed contracts. Dealers Specialties, Inc. v. Neighborhood Hous. Servs., Inc., 54 N.C. App. 46, 283 S.E.2d 155 (1981), modified, 305 N.C. 633, 291 S.E.2d 137 (1982).

The purpose of subsection (2) of this section is to rectify an abuse that had developed in the law of commerce. The custom arose among business people of confirming oral contracts by sending a letter of confirmation. This letter was binding as a memorandum on the sender, but not on the recipient, because he had not signed it. The abuse was that the recipient, not being bound, could perform or not, according to his whim and the market, whereas the seller had to perform. Cudahy Foods Co. v. Holloway, 55 N.C. App. 626, 286 S.E.2d 606 (1982).

Section 75-4 is consistent with the other "statute of frauds" provisions in the law, including G.S. 22-1 and subsection (a) of this section. Manpower of Guilford County, Inc. v. Hedgecock, 42 N.C. App. 515, 257 S.E.2d 109 (1979).

Applicability in Forfeiture Proceeding. — Two companies had met their burden of showing U.S. Const. art. III standing to challenge the government's forfeiture proceeding against seized ginseng by alleging that, pursuant to either G.S. 25-2-501 or Wis. Stat. § 402.501, they paid for part of the seized ginseng and that a portion of the seized ginseng had been identified, marked, or otherwise designated as the ginseng that was to be delivered to them. United States v. 328 Pounds, More Or Less, Of Wild Am. Ginseng, 347 F. Supp. 2d 241, 2004 U.S. Dist. LEXIS 24926 (W.D.N.C. 2004).

Nonmerchant who signs nothing ordinarily will not be bound to a contract under the statute of frauds provision of this section. Currituck Grain, Inc. v. Powell, 28 N.C. App. 563, 222 S.E.2d 1 (1976).

Contract for Services in Repair of Truck. — By its express terms, this section applies only to a contract for the sale of goods. Where the contract was one for services rendered in the repair of a truck, the fact that various parts are also required to properly repair and service the trucks is merely incidental to the repair contract, and does not bar its enforcement, either in its entirety or to the extent of the cost of the parts included. Mack Fin. Corp. v. Harnett Transf., Inc., 42 N.C. App. 116, 256 S.E.2d 491 (1979).

Invoices sent from one party to the other constitute writings "sufficient to indicate that a contract for sale has been made between the parties," within the meaning of this section. Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974).

Letter from Agent of Plaintiff's Assignor. — In an action to recover the purchase price of goods sold to defendant, a letter from the agent of plaintiff's assignor to defendant which identified the company as an agent and which stated that at the time of the sale it was agreed by the assignor that the goods were sold on a "guaranteed sales basis" is enough to comply with the statute of frauds and to make evidence of the guaranteed sales agreement admissible under the parol evidence rule. Equitable Factors Co. v. Chapman-Harkey Co., 43 N.C. App. 189, 258 S.E.2d 376, cert. denied, 298 N.C. 805, 262 S.E.2d 1 (1979).

Insufficient Writings. — Documents relied upon by plaintiff, who furnished material to builder, and signed by defendant for whom home was being constructed did not make out an enforceable contract under this section. Lowe's Cos. v. Lipe, 20 N.C. App. 106, 201 S.E.2d 81 (1973).

Evidence of Alleged Oral Agreement Not Admissible. — Plaintiff was precluded from offering evidence of alleged oral agreement, which tended to contradict written memoranda. Phelps v. Spivey, 126 N.C. App. 693, 486 S.E.2d 226 (1997).

Alleged oral contract between the purchaser and the seller for the sale of motor fuel was unenforceable, as the price of fuel deliveries was over $500 and the contract was not in writing as required by G.S. 25-2-201; thus the purchaser did not establish that the contract was formed. Neugent v. Beroth Oil Co., 149 N.C. App. 38, 560 S.E.2d 829, 2002 N.C. App. LEXIS 143 (2002).

Statute Not Defense for Merchant. — If a merchant receives a written confirmation sufficient as against the sender and fails to give written notice within 10 days, the statute of frauds would not be a defense. Currituck Grain, Inc. v. Powell, 28 N.C. App. 563, 222 S.E.2d 1 (1976).

Whether Farmer Is "Merchant" Is Matter for Proof. — Since the growing and marketing of corn and soybeans is an important part of the agricultural economy of the area, and the procedures for marketing these crops are well known, it cannot be said that a particular farmer or grower is not a "merchant" within the code definition; rather, this is a matter for proof. Currituck Grain, Inc. v. Powell, 28 N.C. App. 563, 222 S.E.2d 1 (1976).

The sale of building materials to be used in the construction of a house may come within the statute of frauds provisions of the Uniform Commercial Code if the value of the building supplies (as goods) prior to construction exceeds $500.00. Smith v. Hudson, 48 N.C. App. 347, 269 S.E.2d 172 (1980).

Agreement to Assume Indebtedness for Equipment Installed in Restaurant. — An agreement whereby the purchaser of a restaurant assumed the original owner's indebtedness for equipment installed in the restaurant, and the seller of the equipment released the original owner from liability, was neither a promise to answer for the debt of another nor a contract for the sale of goods for $500 or more, and the statute of frauds did not apply. Thompson & Little, Inc. v. Colvin, 46 N.C. App. 774, 266 S.E.2d 46 (1980).

Tentative Negotiations Insufficient to Show Contract. — Where plaintiff's evidence merely represented tentative negotiations, it was insufficient to show a contract for the sale of stock. Oakley v. Little, 49 N.C. App. 650, 272 S.E.2d 370 (1980).

Goods Specially Manufactured for Buyer. — Where a lawn mower company orally agreed to purchase all of its requirements for footrest pads from defendant manufacturer, and plaintiff placed label on them and made them specifically for defendant, such contract for the sale of specially manufactured goods did not have to be in writing. Custom Molders, Inc. v. Roper Corp., 101 N.C. App. 606, 401 S.E.2d 96, aff'd per curiam, 330 N.C. 191, 410 S.E.2d 55 (1991).

Oral Contract Made by Telephone for Sale of Yarn. — Evidence of both parties showed that a complete and valid oral contract for the sale of yarn was made by telephone, such oral contract being valid and enforceable since each party admitted "in his pleading, testimony or otherwise in court that a contract of sale was made." Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974).

Output Contract for Sale of Peanuts. — Alleged oral agreement, made in October, after the peanut growing season, when the quantity and quality of the peanut harvest was certain, which changed the terms of an output contract providing for the sale of plaintiff's peanuts, and had a value of more than $500.00, was governed by the Statute of Frauds. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

The facts alleged, taken in the light most favorable to plaintiff, demonstrated no conduct by defendants that would support plaintiff's claim of an oral waiver of the Statute of Frauds with regard to an alleged oral agreement changing the terms of a written output contract for the sale of peanuts. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

Check as a Writing. — A check may constitute a writing sufficient to satisfy the requirements of subsection (1) provided it (1) contains a writing sufficient to indicate a contract of sale between the parties; (2) is signed by the party or his authorized agent against whom enforcement is sought; and (3) states a quantity. Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994).

Personal check which specified the quantity of "five barns" on the "for" line, was signed by plaintiff, and contained an amount was not sufficient to satisfy this section as a writing because defendants, the parties against whom enforcement was sought, did not endorse the check. Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994).

Certificates of Title and Check as a Writing. — Where plaintiff claimed existence of oral contract giving him use and access to mobile home and boats he sold to defendant, the certificates of title and the checks constituted sufficient memoranda to satisfy the requirements of the Statute of Frauds; thus, the documents reflected that defendant held clear title to the mobile home and boats. Phelps v. Spivey, 126 N.C. App. 693, 486 S.E.2d 226 (1997).

Applied in Harwell Enters., Inc. v. Stevens, 9 N.C. App. 228, 175 S.E.2d 739 (1970); Carolina Bldrs. Corp. v. Howard-Veasey Homes, Inc., 72 N.C. App. 224, 324 S.E.2d 626 (1985).

Cited in Grissett v. Ward, 10 N.C. App. 685, 179 S.E.2d 867 (1971); Currituck Grain, Inc. v. Powell, 38 N.C. App. 7, 246 S.E.2d 853 (1978); Danjee, Inc. v. Addressograph Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665 (1980); H.V. Allen Co. v. Quip-Matic, Inc., 47 N.C. App. 40, 266 S.E.2d 768 (1980); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Preston v. Thompson, 53 N.C. App. 290, 280 S.E.2d 780 (1981); Allen M. Campbell Co. v. Virginia Metal Indus., Inc., 708 F.2d 930 (4th Cir. 1983); Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985); Pee Dee Oil Co. v. Quality Oil Co., 80 N.C. App. 219, 341 S.E.2d 113 (1986); Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992); Computer Decisions, Inc. v. Rouse Office Mgt. of N.C., Inc., 124 N.C. App. 383, 477 S.E.2d 262 (1996); Fordham v. Eason, 351 N.C. 151, 521 S.E.2d 701 (1999); United States v. 328 Pounds, More Or Less, Of Wild Am. Ginseng, 347 F. Supp. 2d 241, 2004 U.S. Dist. LEXIS 24926 (W.D.N.C. 2004).

§ 25-2-202. Final written expression; parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of performance, course of dealing, or usage of trade (G.S. 25-1-303); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement. (1965, c. 700, s. 1; 2006-112, s. 3.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross References:

Point 3: Sections 1-205, 2-207, 2-302 and 2-316.

Definitional Cross References:

"Agreed" and "agreement". Section 1-201.
"Course of dealing". Section 1-205.
"Parties". Section 1-201.
"Terms". Section 1-201.
"Usage of trade". Section 1-205.
"Written" and "writing". Section 1-201.

NORTH CAROLINA COMMENT

The purpose of paragraph (a) is to relax the application of the parol evidence rule to written contracts involving the sale of goods. North Carolina has held that where a contract is unambiguous, parol evidence to explain what the contract is, or to add to or vary it, is inadmissible. See Bost v. Bost, 234 N.C. 554, 67 S.E.2d 745 (1951); Pierce v. Cobb, 161 N.C. 300, 77 S.E. 350 (1913). If, on the other hand, terms of uncertain meaning are employed, parol evidence may be admitted to show their meaning in a technical or trade sense. See Layton v. Elba Mfg. Co., 161 N.C. 482, 77 S.E. 677 (1913), where the contract term "car load" was amplified and explained by parol according to custom and usage in a particular business and trade. See also Neal v. Camden Ferry Co., 166 N.C. 563, 82 S.E. 878 (1914).

This UCC provision will allow admission of "course of dealing or usage of trade" evidence even in the absence of ambiguity, thus apparently changing prior North Carolina law. Compare Williamson v. Miller, 231 N.C. 722, 58 S.E.2d 743 (1950). This section would not limit, apparently, parol evidence to an explanation of a term of the written contract.

Paragraph (b) apparently continues prior North Carolina law that when a writing is not complete, consistent additional terms agreed to in parol may be admitted to supply terms on which the writing is silent. See Willis v. Jarrett Constr. Co., 152 N.C. 100, 67 S.E. 265 (1910). The UCC provision says, however, that if the court finds the writing to have been intended as a complete and exclusive statement of the terms of the agreement, evidence of consistent additional terms shall not be added.

The UCC provision seems to indicate a presumption that the written memorandum does not necessarily include all the final terms of the contract—that additional terms may be shown unless the memorandum not only evidences a sale but also that it is in fact the "final and exclusive" statement of terms.

Prior North Carolina law, on the other hand, apparently presumed that a written contract embraces all previous stipulations between the parties and places the burden of showing any ambiguity or omission, or that the writing does not contain all of the terms of the contract upon the party seeking to add to or explain the writing, however consistent the addition may be. See Reynolds v. Palmer, 21 Fed. 433 (W.D.N.C. 1884); Walker v. Horne, 149 F. Supp. 457 (W.D.N.C. 1957); Neal v. Marrone, 239 N.C. 73, 79 S.E.2d 239 (1953).

While the change will not be radical, the parol evidence rule will be liberalized somewhat by this section of the UCC in the absence of an express stipulation that the contract contains the complete and exclusive terms of the contract.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 3, effective October 1, 2006, rewrote subdivision (a).

Legal Periodicals. — For note discussing this section, in light of Fiber Indus., Inc. v. Salem Carpet Mills, Inc., 68 N.C. App. 690, 315 S.E.2d 735, cert. denied, 311 N.C. 754, 321 S.E.2d 132 (1984), see 21 Wake Forest L. Rev. 831 (1986).

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

CASE NOTES

Subdivision (a) of this section clearly limits the use of trade usage evidence to that which explains or supplements the terms of the written agreement. Fiber Indus., Inc. v. Salem Carpet Mills, Inc., 68 N.C. App. 690, 315 S.E.2d 735, cert. denied, 311 N.C. 754, 321 S.E.2d 132 (1984).

Oral Modifications Made Subsequent to Written Contract. — Parol evidence rule bars admission of evidence of any contemporaneous oral agreements or any prior agreements which contradict terms of parties' final written agreement. Parol evidence rule would not bar plaintiff's evidence of oral modifications made subsequent to written contract. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Defendant's subsequent verbal warranties may modify prior written contract and written disclaimer. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Explanatory or supplemental information is not to be admitted when the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement. Fiber Indus., Inc. v. Salem Carpet Mills, Inc., 68 N.C. App. 690, 315 S.E.2d 735, cert. denied, 311 N.C. 754, 321 S.E.2d 132 (1984).

Evidence of Additional Consistent Terms. — A security agreement in which the buyer of a mobile home acknowledged delivery of the mobile home "in good condition and repair" was not intended as a complete and exclusive statement of the terms of the agreement within the meaning of subdivision (b) of this section and the buyer's testimony with respect to the defective condition of the mobile home after it was installed was competent as evidence of additional consistent terms of the sale, where the evidence of both parties showed that the mobile home was to be delivered and set up on defendant's lot and where the security agreement was signed by the buyer before the mobile home was delivered and installed. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Parol Evidence as to Lease-Purchase Agreement. — Under subdivision (a), parol evidence raised by operation of a course of performance may be used in order to help explain and supplement a particular lease-purchase agreement. Robinson v. Branch Moving & Storage Co., 28 N.C. App. 244, 221 S.E.2d 81 (1976).

Parole Evidence Held Inadmissible. — Although defendant's oral statements concerning the condition of the automobile were parole evidence and inadmissible to contradict the terms of a written contract, the evidence was not offered to contradict the contract, but rather to prove an unfair or deceptive practice. Torrance v. AS & L Motors, Ltd., 119 N.C. App. 552, 459 S.E.2d 67 (1995).

Plaintiff was precluded from offering evidence of alleged oral agreement, which tended to contradict written memoranda. Phelps v. Spivey, 126 N.C. App. 693, 486 S.E.2d 226 (1997).

Where plaintiff claimed existence of oral contract giving him use and access to mobile home and boats he sold to defendant, the certificates of title and the checks constituted sufficient memoranda to satisfy the requirements of the Statute of Frauds; thus, the documents reflected that defendant held clear title to the mobile home and boats. Phelps v. Spivey, 126 N.C. App. 693, 486 S.E.2d 226 (1997).

In an adversary proceeding filed by a Chapter 7 trustee, parole evidence concerning what the parties intended concerning the ownership interest of an automobile was not admissible when the promissory note and security agreement executed by the debtor and the creditor established that the debtor had purchased and owned the automobile and that the creditor had retained a security interest, but not an ownership interest in the vehicle. Ivey v. Wilson (In re Payne), — Bankr. —, 2006 Bankr. LEXIS 4199 (Bankr. M.D.N.C. Dec. 6, 2006).

Applied in Equitable Factors Co. v. Chapman-Harkey Co., 43 N.C. App. 189, 258 S.E.2d 376 (1979); Smith v. Hudson, 48 N.C. App. 347, 269 S.E.2d 172 (1980); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992).

Cited in Recreatives, Inc. v. Travel-On Motorcycles Co., 29 N.C. App. 727, 225 S.E.2d 637 (1976).

§ 25-2-203. Seals inoperative.

The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 3. Uniform Sales Act.

Changes: Portion pertaining to "seals" rewritten.

Purposes of Changes:

1. This section makes it clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see Section 2-205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

Cross Reference:
Point 1: Section 2-205.

Definitional Cross References:
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Writing". Section 1-201.

NORTH CAROLINA COMMENT

North Carolina has recognized the effect of a seal; if a contract is under seal it obviates requirement of showing any consideration. See Angier v. Howard, 94 N.C. 27 (1886); Basketeria Stores v. Public Indem. Co., 204 N.C. 537, 168 S.E. 822 (1933). The seal imports consideration. See Thomason v. Bescher, 176 N.C. 622, 97 S.E. 654 (1918); Harrell v. Watson, 63 N.C. 454 (1869); Mordecai's Law Lectures 1053-4; Coleman v. Whisnant, 226 N.C. 258, 37 S.E.2d 693 (1946); McGowan v. Beach, 242 N.C. 73, 86 S.E.2d 763 (1955).

This UCC provision makes the prior law of seals inapplicable to sales contracts in North Carolina and therefore changes North Carolina law. All sealed contracts become simple contracts, requiring other consideration to be shown and resulting in a shorter statute of limitations. See GS 25-2-725. Contracts that were enforceable in North Carolina are not enforceable under this UCC provision.

Legal Periodicals. — For comment on the seal in North Carolina and the need for reform, see 15 Wake Forest L. Rev. 251 (1979).

CASE NOTES

Applied in North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978).

Cited in Mobil Oil Corp. v. Wolfe, 297 N.C. 36, 252 S.E.2d 809 (1979).

§ 25-2-204. Formation in general.

(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes:

Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article.

Under subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to "open terms" underlying later sections of the Article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

Cross References:

Subsection (1): Sections 1-103, 2-201 and 2-302.
Subsection (2): Sections 2-205 through 2-209.
Subsection (3): See Part 3.

Definitional Cross References:

"Agreement". Section 1-201.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Party". Section 1-201.
"Remedy". Section 1-201.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1) accords generally with prior North Carolina law. See Crook v. Cowan, 64 N.C. 743 (1870), and T. C. May Co. v. Menzies Shoe Co., 186 N.C. 144, 119 S.E. 227 (1923), that conduct of the parties may indicate the intention of the parties that a contract exists. This provision is inserted primarily to insure a liberal approach to finding the existence of a contract where the sale of goods is concerned because of a belief that commercial practices often recognize very informal dealings as creating binding obligations.

Subsection (2) has no counterpart in prior North Carolina statutory or decisional law.

Subsection (3) would seem to change North Carolina law to some extent. It was a recognized general principle in North Carolina law that parties to a contract had to assent to the same thing in the same sense, and their minds had to meet as to all terms and if any portion of proposed terms was not settled, or no mode was agreed on by which they might be settled, there was no agreement. Kirby v. Stokes County Bd. of Educ., 230 N.C. 619, 55 S.E.2d 322 (1949); Goeckel v. Stokely, 236 N.C. 604, 73 S.E.2d 618 (1952). But in other instances the North Carolina court retreated from this principle and enforced "output" and "requirements" contracts. See Herren v. Gaines, 63 N.C. 72 (1868); Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904). The court has supplied a "place of delivery" term when the contract was silent. See Fruit Growers' Express Co. v. Plate Ice Co., 59 F.2d 605 (4th Cir. 1935). The court has supplied "time for performance" terms where omitted in a contract otherwise sufficient. See Hurlburt v. Simpson, 25 N.C. 233 (1842); J. B. Colt Co. v. Kimball, 190 N.C. 169, 129 S.E. 406 (1925). See North Carolina Comments under GS 25-2-305, 25-2-306, 25-2-308, 25-2-309, which are related to this section.

In appropriate cases where the parties intend to be bound but omit certain terms from their contract, subsection (3) will substitute external, objective commercial standards in lieu of having the contract declared void for indefiniteness because of the lack of a statement of the specific terms to which the parties might have agreed.

Legal Periodicals. — For note on "Meeting of the Minds and U.C.C. § 2-204," see 46 N.C.L. Rev. 637 (1968).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

Application of the Uniform Commercial Code to Option Contracts for the Sale of Goods, and Implying Promises to Find Sufficient Consideration: Why and How the North Carolina Supreme Court Got It Wrong in Fordham v. Eason, 23 Campbell L. Rev. 49 (2000).

CASE NOTES

Indication of Intent to Be Bound. — A contract binding on both parties was not made until they each did some act indicating their intent to be bound, i.e., recognizing the existence of the contract. Unitrac, S.A. v. Southern Funding Corp., 75 N.C. App. 142, 330 S.E.2d 44 (1985).

Requirements Contract. — Under the North Carolina Uniform Commercial Code, the failure to omit certain material terms will not invalidate the contract because courts are permitted to read into the contract good faith requirements; thus, a contract to purchase pharmaceutical drugs "as required" was not vague, but was instead valid and enforceable. IWTMM, Inc. v. Forest Hills Rest Home, 156 N.C. App. 556, 577 S.E.2d 175, 2003 N.C. App. LEXIS 195 (2003).

Applied in Southern Utils., Inc. v. Jerry Mandel Mach. Corp., 71 N.C. App. 188, 321 S.E.2d 508 (1984); Carolina Bldrs. Corp. v. Howard-Veasey Homes, Inc., 72 N.C. App. 224, 324 S.E.2d 626 (1985).

Cited in Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988); Fordham v. Eason, 351 N.C. 151, 521 S.E.2d 701 (1999).

§ 25-2-205. Firm offers.

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes:

1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memoran-

dum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this Article since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; Section 2-302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

Cross References:

Point 1: Section 1-102.
Point 2: Section 1-102.
Point 3: Section 2-201.
Point 5: Section 2-302.

Definitional Cross References:

"Goods". Section 2-105.
"Merchant". Section 2-104.
"Signed". Section 1-201.
"Writing". Section 1-201.

NORTH CAROLINA COMMENT

This provision reverses prior North Carolina law. If an offer to sell was without consideration, it could be withdrawn by the offeror at any time before acceptance. Durham Life Ins. Co. v. Moize, 175 N.C. 344, 95 S.E. 552 (1918); Winders v. Kenan, 161 N.C. 628, 77 S.E. 687 (1913); Paddock v. Davenport, 107 N.C. 710, 12 S.E. 464 (1890). That an option to purchase under a sealed instrument could not be revoked, see Thomason v. Bescher, 176 N.C. 622, 97 S.E. 654 (1918). This section would make firm offers made by merchants binding and irrevocable, even though not supported by consideration or seal.

Note that the section applies only to "merchants."

Legal Periodicals. — For note on farmers as merchants under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

CASE NOTES

Applied in Fordham v. Eason, 351 N.C. 151, 521 S.E.2d 701 (1999).

Cited in Dogwood Dev. & Mgmt. Co., LLC v. White Oak Transp. Co., — N.C. App. —, 645 S.E.2d 212, 2007 N.C. App. LEXIS 1167 (2007).

§ 25-2-206. Offer and acceptance in formation of contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but such a shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten in this and other sections of this Article.

Purposes of Changes: To make it clear that:

1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense as in Section 2-504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection (1)(b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a non-conforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is non-conforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.

Definitional Cross References:

"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Notifies". Section 1-201.
"Reasonable time". Section 1-204.

NORTH CAROLINA COMMENT

Subsection (1)(a) is designed to reject any technical rules of acceptance of contracts and provides that an offer shall be construed as inviting acceptance in any manner or medium reasonable under the circumstances. This was probably already the law of North Carolina. See Crook v. Cowan, 64 N.C. 743 (1870), which holds that while an assent to the terms of an offer is indispensable, it is not material how or through whom it is given. Of course, an offer by mail carries with it an implied invitation, nothing else appearing, that it may be accepted or rejected by mail. See Board of Educ. v. State Bd. of Educ., 217 N.C. 90, 6 S.E.2d 833 (1939). This subsection would appear to accord with reason. Of course, the offeror can specify a particular mode or manner for effective acceptance.

Subsection (1)(b) apparently has no parallel in prior North Carolina law and is therefore new. It is designed to resolve a trick problem not evidenced by any North Carolina case. The general principle is that an order for goods authorizes acceptance by seller's shipment of the goods. Crook v. Cowan, 64 N.C. 743 (1870).

The trick comes when the seller ships nonconforming goods in response to an order. If these goods were shipped and accepted by the buyer, he had technically accepted a counteroffer. If he rejected the goods, as he had a right to do, he might find himself without any recourse against the seller, as the seller could claim no contract was ever consummated because his acceptance did not conform to the buyer's offer. The Code shifts tactical advantage somewhat. Unless the seller shipping nonconforming goods notifies the buyer that they are being shipped "for accommodation" only, the seller will be held to have accepted the buyer's offer by his shipment—a contract will have been formed.

Subsection (2) was probably already the law in North Carolina. (Compare Crook v. Cowan, 64 N.C. 743 (1870), dissenting opinion of Rodman, J.)

CASE NOTES

Cited in Tom Togs, Inc. v. Ben Elias Indus. Corp., 318 N.C. 361, 348 S.E.2d 782 (1986); Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

§ 25-2-207. Additional terms in acceptance or confirmation.

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;
(b) they materially alter it; or
(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this chapter. (1965, c. 700, s. 1; 1967, c. 562, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of changes:

1. This section is intended to deal with two typical situations. The one is where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal acknowledgments or memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is one in which a wire or letter expressed and intended as the closing or confirmation of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed," or the like.

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore any additional matter contained either in the writing intended to close the deal or in a later confirmation falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional terms.

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been

given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90% or 100% deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due; a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this Article on merchant's excuse by failure of presupposed conditions or a clause fixing in advance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for; a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see Sections 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict, each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2).

Cross References:

See generally Section 2-302.

Point 5: Sections 2-513, 2-602, 2-607, 2-609, 2-612, 2-614, 2-615, 2-616, 2-718 and 2-719.

Point 6: Sections 1-102 and 2-104.

Definitional Cross References:

"Between merchants". Section 2-104.
"Contract". Section 1-201.
"Notification". Section 1-201.
"Reasonable time". Section 1-204.
"Seasonably". Section 1-204.
"Send". Section 1-201.
"Term". Section 1-201.
"Written". Section 1-201.

NORTH CAROLINA COMMENT

This section changes prior North Carolina law. See Morrison v. Parks, 164 N.C. 197, 80 S.E. 85 (1913), that for an acceptance of an offer to become a binding contract, it had to be absolute and unconditional and identical with the offer's terms in all respects and where the acceptance was for a lower price, or specified different kinds of goods, the acceptance was conditional and there was no contract. Wilson v. W. M. Storey Lumber Co., 180 N.C. 271, 104 S.E. 531 (1920). But see Carver v. Britt, 241 N.C. 538, 85 S.E.2d 888 (1955), that where an offer was squarely accepted in positive terms, the addition of a statement relating to ultimate performance of the contract did not make the acceptance conditional and prevent the formation of the contract. In other words, if the acceptance varied materially with the offer and was conditional, there would be no contract. But if the acceptance added terms that were not material or which were minor, or which represented in effect a request, or proposal of alteration or modification, made after an unconditional acceptance of an offer, this would not affect the contract. Compare Richardson v. Greensboro Warehouse & Storage Co., 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

Subsection (1): Under subsection (1) of this section the additional or different terms in the acceptance are not treated as "conditions to acceptance," constituting a counteroffer, but result in a completed contract. The added or different terms set out in the acceptance do not become a part of the contract as between ordinary sellers and purchasers (nonmerchants) but become addenda to the contract which merely "propose" or "suggest" such additional or different terms.

Subsection (2): Under subsection (2), as to "merchants" contracts, if there are additional or different terms in the acceptance or confirmation, the additional or different terms of the acceptance become a part of the contract unless (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to such terms is given within a reasonable time.

Subsection (3) accords with J. W. Sanders Cotton Mill v. Capps, 104 F. Supp. 617 (E.D.N.C. 1952), that an acceptance and a binding contract may result from acts and conduct even though writings of the parties may not by themselves constitute a contract.

Legal Periodicals. — For note on farmers as merchants under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "Restoring Peace in the Battle of the Forms: A Framework for Making Uniform Commercial Code Section 2-207 Work," see 69 N.C.L. Rev. 893 (1991).

CASE NOTES

Invoices sent from one party to the other constituted a "written confirmation" of a previously made oral contract for sale, within the meaning of this section. Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974).

Inclusion of Term Not Previously Agreed upon Constitutes Proposal for Addition. — When one party to a valid oral contract for the sale of goods, within a reasonable time after the making of such contract, sends to the other party a document purporting to set out in writing the terms of the contract and includes therein a term not previously agreed upon, this constitutes a proposal for an addition to the contract. Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974).

Which May Become Part of Contract Unless Materially Altering It. — When the parties to the contract are "merchants," as that term is defined in G.S. 25-2-104(1), all proposed additional terms, to which the other party does not object in due time, become part of the contract, unless "they materially alter it." Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974).

Term which so drastically affects remedies available to buyer upon seller's breach must be considered material alteration when not explicitly negotiated by the parties. Therefore, plaintiff's attempt to add a disclaimer of warranties to the parties' contracts was ineffective. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

An addition to an oral contract inserting an "arbitration only" term was a material alteration of the contract, and could not be deemed incorporated into the contract for sale by reason of the mere silence of one party following its receipt of the other party's invoices containing the term. Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 285 N.C. 344, 204 S.E.2d 834 (1974); Supak & Sons Mfg. Co. v. Pervel Indus., Inc., 593 F.2d 135 (4th Cir. 1979).

An arbitration clause was such a material alteration of plaintiff's oral contract of purchase that it did not become binding on the plaintiff who never recognized, acknowledged or signed an agreement that its oral contract should be so amended or modified. Supak & Sons Mfg. Co. v. Pervel Indus., Inc., 463 F. Supp. 177 (E.D.N.C. 1978).

There is no conflict between 9 U.S.C. § 2, which provides for the validity and enforceability of arbitration clauses in contracts evidencing transactions in interstate commerce, and the decisional law of North Carolina holding an arbitration clause to be a per se material alteration under this section. Supak & Sons Mfg. Co. v. Pervel Indus., Inc., 593 F.2d 135 (4th Cir. 1979).

"Yarn Contracts" Attempting to Attach Additional Terms to Oral Contracts. — Where defendant's "yarn contracts" served not only to confirm oral telephone contracts between the parties but also attempted to attach additional terms to the agreement, to allow additional terms, which were material alterations, under the guise of "confirmation of the contract" would render this section meaningless. Frances Hosiery Mills, Inc. v. Burlington Indus., Inc., 19 N.C. App. 678, 200 S.E.2d 668, aff'd, 285 N.C. 344, 204 S.E.2d 834 (1974).

Arbitration clauses contained in contracts received by buyers from sellers of cotton yarn contravened public policy because they reduced the period of limitations that the buyers had to seek damages on their claim of violation of the Sherman Act by conspiring to fix prices for cotton yarn sold in the United States, and did not allow buyers to join all sellers in arbitration; the clauses were excised from the buyers' contracts and arbitration was not ordered. In re Cotton Yarn Antitrust Litig., 406 F. Supp. 2d 585, 2005 U.S. Dist. LEXIS 28777 (M.D.N.C. 2005).

Applied in General Time Corp. v. Eye Encounter, Inc., 50 N.C. App. 467, 274 S.E.2d 391 (1981).

§ 25-2-208: Repealed by Session Laws 2006-112, s. 4, effective October 1, 2006.

Cross References. — For present provisions similar to repealed G.S. 25-2-208, see G.S. 25-1-303.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

§ 25-2-209. Modification, rescission and waiver.

(1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this article (G.S. 25-2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1)—Compare Section 1, Uniform Written Obligations Act; Subsections (2) to (5)—none.

Purposes of Changes and New Matter:

1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (Section 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes a performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under Sections 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in Green v. Doniger, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The Statute of Frauds provisions of this Article are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

Cross References:

Point 1: Section 1-203.

Point 2: Sections 1-201, 1-203, 2-615 and 2-616.

Point 3: Sections 2-106, 2-201 and 2-202.

Point 4: Sections 2-202 and 2-208.

Definitional Cross References:

"Agreement". Section 1-201.

"Between merchants". Section 2-104.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Signed". Section 1-201.

"Term". Section 1-201.

"Writing". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1) makes a change in prior North Carolina law. North Carolina held that a consideration is necessary in order to make binding an agreement modifying or discharging a contract. See Lipschutz v. Weatherly, 140 N.C. 365, 53 S.E. 132 (1906); Brown v. Catawba River Lumber Co., 117 N.C. 287, 23 S.E. 253 (1895).

Subsection (2) changes prior North Carolina law. See Childress v. C. W. Myers Trading Post, Inc., 247 N.C. 150, 100 S.E.2d 391 (1957), which holds that a written contract may be modified or waived by a subsequent parol agreement even though the instrument provides that any modification must be in writing. Subsection (2) permits the parties to prescribe their own "statute of frauds" so to speak by requiring modifications of the contract to be in writing. The last part of subsection (2) (after the comma) provides that a merchant-seller's contract form limiting modification by a buyer (who is not a merchant), specifying that it shall be modified only by a writing, will not limit the nonmerchant buyer unless he separately signs the instrument containing such limitation.

Subsection (3) makes it clear that if contract as modified would be within the statute of frauds provision, the modification must be in writing.

Subsection (4) attempts to provide an equitable solution to situations where there is conduct or parol agreement which would evince intention to modify the contract but for the requirements of subsections (2) and (3). This subsection would seem to accord with prior law in North Carolina. See Childress v. C. W. Myers Trading Post, Inc., 247 N.C. 150, 100 S.E.2d 391 (1957); Whitehurst v. FCX Fruit & Vegetable Serv., 224 N.C. 628, 32 S.E.2d 34 (1944); H. M. Wade Mfg. Co. v. Lefkowitz, 204 N.C. 449, 168 S.E. 517 (1933), which indicate that the doctrine of waiver, in proper cases, is now as firmly established as the doctrine of rigidity and inflexibility of the written word. The latter case defines waiver: "A waiver takes place where a man dispenses with the performance of something which he has a right to exact. A man may do that not only by saying that he dispenses with it, that he excuses the performance, or he may do it as effectually by conduct which naturally and justly leads the other party to believe that he dispenses with it. There can be no waiver unless so intended by one party, and so understood by the other, or one party has so acted as to mislead the other."

Subsection (4), according to the Official Comment, is directed primarily toward *conduct* after formation of the contract which will constitute a waiver notwithstanding a provision in the contract that excludes modification or rescission except by a signed writing.

Subsection (5): No statutory or decisional parallel has been located concerning the retraction of a waiver as provided for in subsection (5).

Legal Periodicals. — For note on farmers as merchants under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "The Regulation of Contractual

Change: A Guide to No Oral Modification Clauses for North Carolina Lawyers," see 81 N.C.L. Rev. 2239 (2003).

CASE NOTES

The clear intent of subsection (4) of this section is to give legal effect to the parties' actual later conduct. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

The references in subsection (5) of this section to waiver affecting an executory portion of the contract and to performance and retraction make it reasonable to conclude that "waiver" is employed with reference to the terms of the contract, not the statute of frauds. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

"Conduct" involves more than a mere oral agreement. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

Waiver for Failure to Plead or Raise Issues. — Failure of the parties to plead or to raise the issues of the statute of frauds, waiver of the disclaimers, and retraction and estoppel resulted in waiver thereof. Bone Int'l, Inc. v. Johnson, 74 N.C. App. 703, 329 S.E.2d 714 (1985).

Evidence of Oral Waiver of Disclaimers Created Issue of Fact. — Even though there was no writing evidencing alleged subsequent oral modification of sales agreement, where buyer presented evidence that seller orally waived written disclaimers and that buyer relied on this waiver to his detriment, this created an issue of fact for the jury on the question of waiver under subsections (4) and (5) of this section, which was not subject to the statute of frauds. Bone Int'l, Inc. v. Johnson, 74 N.C. App. 703, 329 S.E.2d 714 (1985).

Seller's post-sale agreement with buyer to do major engine repairs without charge constituted an oral modification of original written agreement that there were no warranties, and was not subject to the parol evidence rule. Further, under subsection (1), this agreement needed no consideration to be binding. Bone Int'l, Inc. v. Johnson, 74 N.C. App. 703, 329 S.E.2d 714 (1985).

Output Contract for Sale of Peanuts. — Alleged oral agreement, made in October, after the peanut growing season, when the quantity and quality of the peanut harvest was certain, which changed the terms of an output contract providing for the sale of plaintiff's peanuts, and had a value of more than $500.00, was governed by the statute of frauds. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

The facts alleged, taken in the light most favorable to plaintiff, demonstrated no conduct by defendants that would support plaintiff's claim of an oral waiver of the Statute of Frauds with regard to an alleged oral agreement changing the terms of a written output contract for the sale of peanuts. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

Creditor's Letter Served As An Offer to Modify. — Evidence presented supported the conclusion that the letter sent by the creditor to the debtor served as an offer to modify the monthly payment term to $155 month and the debtor accepted by performance of tendering payment as requested, G.S. 25-2-209 and G.S. 25-2-208 (repealed; see G.S. 25-1-303); the payments are relevant evidence to show a modification of the contract. In re McClamrock, — Bankr. —, 2003 Bankr. LEXIS 1781 (Bankr. M.D.N.C. July 21, 2003).

Price Increase Did Not Violate Contract. — North Carolina Uniform Commercial Code, G.S. 25-2-209(1), abrogates the common law preexisting duty rule and does not require additional consideration for contract modifications; therefore, an apparel assembler did not breach its contract with an apparel company that supplied it with cut shirt parts when it obtained an increase in the assembly price paid to it by the company. Sara Lee Corp. v. Quality Mfg., 201 F. Supp. 2d 608, 2002 U.S. Dist. LEXIS 27687 (M.D.N.C. 2002).

Applied in Danjee, Inc. v. Addressograph Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665 (1980).

Cited in Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992); Dealers Supply Co. v. Cheil Indus., 348 F. Supp. 2d 579, 2004 U.S. Dist. LEXIS 25313 (M.D.N.C. 2004).

§ 25-2-210. Delegation of performance; assignment of rights.

(1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No

delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Except as otherwise provided in G.S. 25-9-406, unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) of this section unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective, but (i) the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer, and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

(4) Unless the circumstances indicate the contrary, a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(5) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(6) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee. (1965, c. 700, s. 1; 2000-169, s. 9.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Prior Uniform Statutory Provision: None.

Purposes:

1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. Subsection (2) is subject to Section 9-406, which makes rights to payment for goods sold ("accounts"), whether or not earned, freely alienable notwithstanding a contrary agreement or rule of law.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved. This Article and this section are intended to clarify this problem, particularly in cases dealing with output requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in

subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is barred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This Article takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the assignment. This question is dealt with in the Article on Secured Transactions (Article 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this Article touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article 9.

Cross References:

Point 3: Articles 5 and 9.
Point 4: Sections 2-306 and 2-609.
Point 5: Article 9, Sections 9-317 and 9-318.
Point 7: Article 9.

Definitional Cross References:

"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Party". Section 1-201.
"Rights". Section 1-201.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1): The first sentence of subsection (1) is consistent with decisional law in North Carolina that contracts for the sale and purchase of merchandise, not involving a personal element or a relation of personal confidence, are assignable by either party. See Gulf States Creosoting Co. v. Loving, 120 F.2d 195 (4th Cir. 1941) and cases there cited. See Restatement, Contracts §§ 151, 152 (1932). That executory contracts involving personal confidence or reliance on character, skill, business standing, or capacity cannot be assigned is set forth in Atlantic & N.C.R.R. v. Atlantic & N.C. Co., 147 N.C. 368, 61 S.E. 185 (1908).

The second sentence of subsection (1) also accords with North Carolina decisional law. That a delegation of performance does not relieve the assignor or delegator, see Atlantic & N.C.R.R. v. Atlantic & N.C. Co., 147 N.C. 368, 61 S.E. 185 (1908).

Subsection (2): The first sentence of subsection (2) accords with prior North Carolina law. See Atlantic & N.C.R.R. v. Atlantic & N.C. Co., 147 N.C. 368, 61 S.E. 185 (1908). The second sentence of subsection (2) makes choses in action arising out of executed contracts assignable, notwithstanding an agreement in the contract not to assign. While Gulf States Creosoting Co. v. Loving, 120 F.2d 195 (4th Cir. 1941), holds that a cause of action for breach of contract is assignable, the provision in the UCC that a cause of action is assignable despite a contrary agreement will apparently be new in North Carolina.

Subsection (3) apparently has no statutory or decisional parallel in North Carolina.

Subsection (4) accords with Atlantic & N.C.R.R. v. Atlantic & N.C. Co., 147 N.C. 368, 61 S.E. 185 (1908), that an assignee assumes both the benefits and burdens upon an assignment of a contract. That an assignor can maintain an action against his assignee for nonperformance of duties imposed in an assigned contract is also held in the *Atlantic & N.C.R.R.* case. Implicit also is the rule that a third party who was an original party to a contract assigned may maintain a suit directly against an assignee for nonperformance of the contract assumed. Compare the analogous situation where a transferee of mortgaged property who assumes the obligation which the mortgage secures is directly and personally liable to the holder of the mortgage on the mortgage debt. Rector v. Lyda, 180 N.C. 577, 105 S.E. 170 (1920); Parlier v. Miller, 186 N.C. 501, 119 S.E. 898 (1923).

Subsection (5) making assignment delegating performance grounds for insecurity entitling the other party to further assurances has no parallel in decisional or statutory law in North Carolina.

Legal Periodicals. — For an article on executory contracts and performance decisions in bankruptcy, see 46 Duke L.J. 517 (1996).

CASE NOTES

Assignment of Legal Rights. — Right to assign legal rights is not exclusively governed by the UCC. Even if a party technically is not a "buyer" under the UCC, as long as it has a valid claim for breach of contract against defendant, the common law will permit its assignment. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Because buyer had a valid claim that it could assert by itself, plaintiff as assignee was entitled to assert its claim against defendant. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Applied in Webber v. McCoy Lumber Co., 62 N.C. App. 740, 303 S.E.2d 408 (1983).

Cited in Rose v. Vulcan Materials Co., 282 N.C. 643, 194 S.E.2d 521 (1973).

PART 3.

General Obligation and Construction of Contract.

§ 25-2-301. General obligations of parties.

The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 11 and 41, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes:

This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this Article such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that Act on the effect of conditions. In order to determine what is "in accordance with the contract" under this Article usage of trade, course of dealing and performance, and the general background of circumstances must be given due consideration in conjunction with the lay meaning of the words used to define the scope of the conditions and duties.

Cross References:

Section 1-106. See also Sections 1-205, 2-208, 2-209, 2-508 and 2-612.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Party". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section reflects the prior law of North Carolina and would seem to require no comment. See and compare McAden v. Craig, 222 N.C. 497, 24 S.E.2d 1 (1942).

CASE NOTES

Prima Facie Case Presents Jury Question. — Seller's allegation of the sale and delivery of goods at an agreed price and buyer's admission that he purchased the goods, executed the note and security agreement and refused to pay a portion of the purchase price agreed upon makes out a prima facie case entitling seller to go to the jury and, nothing else appearing, to recover the balance due on the note. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Applied in Southern Utils., Inc. v. Jerry Mandel Mach. Corp., 71 N.C. App. 188, 321 S.E.2d 508 (1984).

Cited in American Imports, Inc. v. G.E. Employees W. Region Fed. Credit Union, 37 N.C. App. 121, 245 S.E.2d 798 (1978).

§ 25-2-302. Unconscionable contract or clause.

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination. (1971, c. 1055, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None

Purposes:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E.2d 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for nondelivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross Reference:

"Contract". Section 1-201.

Legal Periodicals. — For note on strict liability for breach of warranty, see 50 N.C.L. Rev. 697 (1972).

For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

For note, "State Law of Contract Formation in the Shadow of the Federal Arbitration Act," see 46 Duke L.J. 651 (1996).

For article on the impact of automated rights management on copyright's fair use doctrine, see 76 N.C.L. Rev. 557 (1998).

CASE NOTES

Purpose. — As the official comment to this statute makes clear, the purpose behind this section is to permit the courts to do openly what they have been doing for many years in a semi-covert way. Rite Color Chem. Co. v. Velvet Textile Co., 105 N.C. App. 14, 411 S.E.2d 645 (1992).

Under subsection (1), determination of unconscionability is a question of law for the court. Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

Unconscionability is an affirmative defense, and the party asserting it bears the burden of establishing it. Rite Color Chem. Co. v. Velvet Textile Co., 105 N.C. App. 14, 411 S.E.2d 645 (1992).

§ 25-2-303. Allocation or division of risks.

Where this article allocates a risk or a burden as between the parties "unless otherwise agreed," the agreement may not only shift the allocation but may also divide the risk or burden. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:

None.

Purposes:

1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this Article as they desire, always subject, of course, to the provisions on unconscionability.

Compare Section 1-102(4).

2. The risk or burden may be divided by the express terms of the agreement or by the at-

tending circumstances, since under the definition of "agreement" in this Act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

Cross References:
Point 1: Sections 1-102, 2-302.
Point 2: Section 1-201.

Definitional Cross References:
"Party". Section 1-201.
"Agreement". Section 1-201.

NORTH CAROLINA COMMENT

This section accords with prior North Carolina law. The risk followed title under such law. Penniman v. Winder, 180 N.C. 73, 103 S.E. 908 (1920). Title passed according to the intent of the parties. Teague v. Howard Grocery Store, 175 N.C. 195, 95 S.E. 173 (1918). Therefore, allocation of risks and burdens could be shifted and allocated by agreement.

§ 25-2-304. Price payable in money, goods, realty, or otherwise.

(1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsections (2) and (3) of Section 9, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes:

1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accuracy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under subsection (1) the provisions of this Article are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole Article applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons of the Article must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this Article apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regulation of various particular contracts which fall outside the scope of this Article is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this Article. In contrast, this Article declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this Article control.

Cross References:
Point 1: Section 1-102.
Point 3: Sections 1-102, 1-103, 1-104 and 2-107.

Definitional Cross References:
"Goods". Section 2-105.
"Money". Section 1-201.
"Party". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This would not materially change the prior law of sales, but State v. Albarty, 238 N.C. 130, 76 S.E.2d 381 (1953), holds that for purposes of criminal law a barter is not a sale. See, however, State v. Colonial Club, 154 N.C. 177, 69 S.E. 771 (1910), that a sale is a transmutation of property from one man to another in consideration of some price or recompense in value.

The UCC adds, however, the idea that both traders in a barter situation are both sellers. The UCC provides that the rules herein stated will govern only the barterer of personal property if land is bartered for personal property.

§ 25-2-305. Open price term.

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

(a) nothing is said as to price; or

(b) the price is left to be agreed by the parties and they fail to agree; or

(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 9 and 10, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes:

1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended by the parties to be a binding agreement. This Article rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness". Instead this Article recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this Article recognizes remedies such as cover (Section 2-712), resale (Section 2-706) and specific performance (Section 2-716) which go beyond any mere arithmetic as between contract price and market price, there is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of subsection (1) ("The parties *if they so intend*") and in subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price," or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For

example, the case where a known and trusted expert is to "value" a particular painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act. (Section 1-203).

Cross References:

Point 1: Sections 2-204(3), 2-706, 2-712 and 2-716.
Point 3: Section 2-103.
Point 5: Sections 2-311 and 2-610.
Point 6: Section 1-203.

Definitional Cross References:

"Agreement". Section 1-201.
"Burden of establishing". Section 1-201.
"Buyer". Section 2-103.
"Cancellation". Section 2-106.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Fault". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Receipt of goods". Section 2-103.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1): Subsections (1)(a) and (b), which state that parties can conclude a sales contract even though the price is not settled, conflict with and change North Carolina law as set out in Wittkowsky v. Wasson, 71 N.C. 451 (1874): "There cannot be an executed sale as to pass the property where the price is to be fixed by agreement between the parties afterwards, and the parties do not afterwards agree." If, however, the thing sold has been delivered to the vendee and consumed, so that the parties cannot be put in *status quo,* the vendee is liable for a reasonable price. Benjamin, Sales, quoted with approval in Wittkowsky v. Wasson, 71 N.C. 451 (1874).

There are apparently no cases on subsection (1)(c), but it would also conflict with the reasoning of the *Wittkowsky* case.

Subsection (2): There are apparently no cases relating exactly to subsection (2), but it seems to change the contracts rule set forth in Kirby v. Stokes County Bd. of Educ., 230 N.C. 619, 55 S.E.2d 322 (1949) that: "One of the essential elements of every contract is mutuality of agreement. There must be neither doubt nor difference between the parties. They must assent to the same thing in the same sense and their minds must meet as to all the terms. If any portion of the proposed terms is not settled, or no mode agreed on by which they may be settled, there is no agreement." Compare Richardson v. Greensboro Warehouse & Storage Co., 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

It would seem that under this UCC section contracts of sale are enforceable that would not have been enforceable under prior North Carolina Law.

Subsections (3) and (4): There are no parallels in prior North Carolina law to the other subsections of GS 25-2-305.

It should be noted that subsection (4), as well as the first sentence of this section, pays careful attention to the intention of the parties and a contract is not enforceable under the conditions set out unless the contracting parties intend to be bound.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Fixed Price Formula. — Once a buyer or a seller sets a formula or standard to determine the price in a contract pursuant to G.S. 25-2-305, both parties must abide by that formula or standard until mutually amended or changed. Neugent v. Beroth Oil Co., 149 N.C. App. 38, 560 S.E.2d 829, 2002 N.C. App. LEXIS 143 (2002).

Applied in Carolina Bldrs. Corp. v. Howard-Veasey Homes, Inc., 72 N.C. App. 224, 324 S.E.2d 626 (1985).

Cited in Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986); Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323, 2002 U.S. App. LEXIS 5006 (Fed. Cir. 2002); Sara Lee Corp. v. Quality Mfg., 201 F. Supp. 2d 608, 2002 U.S. Dist. LEXIS 27687 (M.D.N.C. 2002).

§ 25-2-306. Output, requirements and exclusive dealings.

(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem the general approach of this Act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in Southwest Natural Gas Co. v. Oklahoma Portland Cement Co., 102 F.2d 630 (C.C.A. 10, 1939). This Article takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this Article, and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this Act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use reasonable

diligence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of subsection (1). It also raises questions of insecurity and right to adequate assurance under this Article.

Cross References:

Point 4: Section 2-210.
Point 5: Sections 1-203 and 2-609.

Definitional Cross References:

"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Good faith". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Term". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

North Carolina accords with subsection (1). North Carolina has recognized "output" and "requirements" contracts. Herren v. Gaines, 63 N.C. 72 (1868); Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904). The limitation to "good faith output" and "good faith requirements" apparently has no parallel in North Carolina, although such limitation seems reasonable.

No North Carolina authority has been found upon subsection (2).

Legal Periodicals. — For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Output Contract for Sale of Peanuts. — Alleged oral agreement, made in October, after the peanut growing season, when the quantity and quality of the peanut harvest was certain, which changed the terms of an output contract providing for the sale of plaintiff's peanuts, and had a value of more than $500.00, was governed by the Statute of Frauds. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

The facts alleged, taken in the light most favorable to plaintiff, demonstrated no conduct by defendants that would support plaintiff's claim of an oral waiver of the Statute of Frauds with regard to an alleged oral agreement changing the terms of a written output contract for the sale of peanuts. Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

Requirement Contract for Sale of Pharmaceutical Drugs. — "Good faith" obligation applies for output contracts; a contract to purchase pharmaceutical drugs "as required" was not vague, but was instead valid and enforceable. IWTMM, Inc. v. Forest Hills Rest Home, 156 N.C. App. 556, 577 S.E.2d 175, 2003 N.C. App. LEXIS 195 (2003).

Applied in Carolina Bldrs. Corp. v. Howard-Veasey Homes, Inc., 72 N.C. App. 224, 324 S.E.2d 626 (1985).

Cited in B.B. Walker Co. v. Ashland Chem. Co., 474 F. Supp. 651 (M.D.N.C. 1979); Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92 (1986).

§ 25-2-307. Delivery in single lot or several lots.

Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 45(1). Uniform Sales Act.

Changes: Rewritten and expanded.

Purposes of Changes:

1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original Act, Section 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire amount of brick at once, or it may be necessary to assemble the goods as in the case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of Section 2-609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of Section 2-503 on manner of tender of delivery. This is reinforced by the express provisions of Section 2-608 that if a lot has been accepted on the reasonable assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of Kelly Construction Co. v. Hackensack Brick Co., 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in Lynn M. Ranger, Inc. v. Gildersleeve, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

Cross References:

Point 1: Section 1-201.
Point 2: Sections 2-508 and 2-601.
Point 3: Sections 2-503, 2-608 and 2-609.

Definitional Cross References:

"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Lot". Section 2-105.
"Party". Section 1-201.
"Rights". Section 1-201.

NORTH CAROLINA COMMENT

There are apparently no North Carolina statutes or cases which relate directly to the subject matter of this section. It is therefore new.

§ 25-2-308. Absence of specified place for delivery.

Unless otherwise agreed
(a) the place for delivery of goods is the seller's place of business or if he has none, his residence; but
(b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and
(c) documents of title may be delivered through customary banking channels. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Paragraphs (a) and (b)—Section 43(1), Uniform Sales Act; Paragraph (c)—none.

Changes: Slight modification in language.

Purposes of Changes and New Matter:

1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement", the seller's duties as to delivery of the goods are governed not by this section but by Section 2-504.

2. Under paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are on hand, leaving the buyer himself to see to the physical receipt of the goods, tender at the buyer's address is not required under paragraph (c). But that paragraph merely eliminates the possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by documents or has undertaken its collection on behalf of the seller, Part 5 of Article 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the Article on Letters of Credit spells out the duties and relations between the bank, the seller and the buyer.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement".

Cross References:

Point 1: Sections 2-504 and 2-505.
Point 2: Section 2-503.
Point 3: Section 2-512, Articles 4, Part 5, and 5.

Definitional Cross References:

"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (a) accords with prior North Carolina law that where no place for delivery is specified and no contrary intention is shown, the place of delivery is the seller's place of business. See Fruit Growers' Express Co. v. Plate Ice Co., 59 F.2d 605 (4th Cir. 1935). There seems to be no North Carolina authority as to the other two subsections.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

§ 25-2-309. Absence of specific time provisions; notice of termination.

(1) The time for shipment or delivery or any other action under a contract if not provided in this article or agreed upon shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other

party and an agreement dispensing with notification is invalid if its operation would be unconscionable. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1)—see Sections 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article, Subsection (2)—none; Subsection (3)—none.

Changes: Completely different in scope.

Purposes of Changes and New Matter:

1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in Sections 1-203, 1-204 and 2-103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is "agreed" by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in Section 2-513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this Article impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this Article as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which may amount without more to breach or to create breach by the other side. See Sections 2-207 and 2-609.

5. The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver.

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this Article pending further negotiations. Only when a party insists on undue delay or on rejection of the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

Cross References:

Point 1: Sections 1-203, 1-204 and 2-103.

Point 2: Sections 2-320, 2-321, 2-504, and 2-511 through 2-514.

Point 5: Section 1-203.

Point 6: Section 2-609.

Point 7: Section 2-204.

Point 9: Sections 2-106, 2-318, 2-610 and 2-703.

Definitional Cross References:

"Agreement". Section 1-201.
"Contract". Section 1-201.
"Notification". Section 1-201.
"Party". Section 1-201.
"Reasonable time". Section 1-204.
"Termination". Section 2-106.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law. See Ober & Sons Co. v. Katzenstein, 160 N.C. 439, 76 S.E. 476 (1912), which holds that when no time for shipment is specified in contract for sale of goods, there is an implied understanding that shipment will be within a reasonable time. If no particular time is set in contract for delivery, it must be within a reasonable time. Hurlburt v. Simpson, 25 N.C. 233 (1842); J. B. Colt Co. v. Kimball, 190 N.C. 169, 129 S.E. 406 (1925).

Subsections (2) and (3) also accord with prior North Carolina law that a contract calling for successive and continuing performances, wherein no time is fixed during which the contract is to last and none is fixed by usage, may be terminated at the will of either of the parties upon notice being given to the other party. See Pool v. Walker, 156 N.C. 40, 72 S.E. 70 (1911). The UCC provision requires "reasonable notification" which is probably implicit in the North Carolina decision.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

The UCC specifically emphasizes the ability of the parties to fix by agreement their rights to terminate a contract for the sale of goods, "termination" being defined under G.S. 25-2-106(3) as the event which occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92, cert. denied, 317 N.C. 336, 346 S.E.2d 502 (1986).

A contract which contains no definite term as to its duration is terminable at will by either party upon reasonable notice after a reasonable time. Citrini v. Goodwin, 68 N.C. App. 391, 315 S.E.2d 354 (1984).

A contract calling for successive and continuing performances which was indefinite in duration was terminable at will under common law in North Carolina and could be terminated by either party upon giving reasonable notice. The common-law rule is carried forward by subsection (2) of this section. Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92, cert. denied, 317 N.C. 336, 346 S.E.2d 502 (1986).

Ambiguous Letter Agreement. — Letter agreement which stated that plaintiff would continue as a distributor of defendant's products indefinitely, but went on to provide that defendant would continue to sell its products to distributor for so long as its purchases did not fall below $51,000.00, in which event either party was given a right of termination, and that the right to terminate at any time, without regard to the amount of purchases, was reserved only to distributor, was unclear and ambiguous as to whether the contract was of indefinite duration and terminable at the will of either party, or whether defendant's right to terminate was conditioned on distributor's failure to meet the minimum purchase levels. Parker Marking Sys. v. Diagraph-Bradley Indus., Inc., 80 N.C. App. 177, 341 S.E.2d 92, cert. denied, 317 N.C. 336, 346 S.E.2d 502 (1986), reversing summary judgment in favor of defendant, whom distributor alleged had unlawfully terminated the agreement.

Where the buyer had agreed to pay in full prior to delivery, and he testified that he knew that the seller would ship the piece of equipment once the price for it was paid, that being the original agreement, the seller's letters requesting payment and impliedly offering delivery were expressions of desire or intention, requesting the assent or acquiescence of the other party, not amounting to breach. Southern Utils., Inc. v. Jerry Mandel Mach. Corp., 71 N.C. App. 188, 321 S.E.2d 508 (1984), cert. denied, 313 N.C. 510, 329 S.E.2d 395 (1985).

Applied in Superior Foods, Inc. v. Harris-Teeter Super Mkts., Inc., 288 N.C. 213, 217 S.E.2d 566 (1975).

Cited in Foley v. L & L Int'l, Inc., 88 N.C. App. 710, 364 S.E.2d 733 (1988).

§ 25-2-310. Open time for payment or running of credit; authority to ship under reservation.

Unless otherwise agreed

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and

(b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (G.S. 25-2-513); and

(c) if delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due regardless of where the goods are to be received (i) at the time and place at which the buyer is to receive delivery of the tangible documents or (ii) at the time the buyer is to receive delivery of the electronic documents and at the seller's place of business or if none, the seller's residence; and

(d) where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but postdating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period. (1965, c. 700, s. 1; 2006-112, s. 29.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 42 and 47(2), Uniform Sales Act.

Changes: Completely rewritten in this and other sections.

Purposes of Changes: This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus:

1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery except in documentary shipment cases (paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give up possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article 4. In the absence of a credit term, the seller is permitted to ship under reservation and if he does payment is then due where and when the buyer is to receive the documents.

3. Unless otherwise agreed, the place for the receipt of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under paragraph (b), and Sections 2-512 and 2-513 the buyer is under no duty to pay prior to inspection.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit adequate inspection before receipt, the seller must be guided by the provisions of this Article on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time of shipment. The provision concerning any delay in sending forth the invoice is included because

such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

Cross References:

Generally: Part 5.
Point 1: Section 2-509.
Point 2: Sections 2-505, 2-511, 2-512, 2-513 and Article 4.
Point 3: Sections 2-308(b), 2-512 and 2-513.
Point 4: Section 2-513(3) (b).

Definitional Cross References:

"Buyer". Section 2-103.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Receipt of goods". Section 2-103.
"Seller". Section 2-103.
"Send". Section 1-201.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (a) accords with prior North Carolina law which makes the payment of money and the delivery of property simultaneous or concurrent conditions. McAden v. Craig, 222 N.C. 497, 24 S.E.2d 1 (1942); Hughes v. Knott, 138 N.C. 105, 50 S.E. 586 (1905); Wessel v. Seminole Phosphate Co., 13 F.2d 999 (4th Cir. 1926).

Subsection (b) accords with Standard Paint & Lead Works v. Spruill, 186 N.C. 68, 118 S.E. 891 (1923), that goods shipped from a distance point are subject to inspection by the buyer before he becomes liable for the purchase price in the absence of a contractual provision to the contrary.

Subsection (c) accords with common commercial understanding that shipment under C.O.D. contracts and the like deprives the buyer of the right to inspect goods shipped prior to payment. Delivery is not to be made in C.O.D. shipments until payment has been made.

Subsection (d) has no statutory or decisional parallel.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 29, effective October 1, 2006, rewrote subsection (c).

§ 25-2-311. Options and cooperation respecting performance.

(1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of G.S. 25-2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in subsections (1) (c) and (3) of G.S. 25-2-319 specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

(a) is excused for any resulting delay in his own performance; and
(b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably forthcoming; the subsection relieves the other party from the necessity for performance or excuses his delay in performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies". The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in subsection (3) is one which does not operate in the situation which falls within the scope of Section 2-164 on substituted performance. Where the failure to cooperate results from circumstances set forth in that section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the non-cooperating party.

Cross References:

Point 1: Sections 1-201, 2-204 and 1-203.
Point 3: Sections 1-203 and 2-609.
Point 4: Section 2-614.

Definitional Cross References:

"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Party". Section 1-201.
"Remedy". Section 1-201.
"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

The entire section is new and seems to change prior North Carolina law. It states that a contract of sale is not made invalid because particulars of performance are left to be specified by one of the parties. That such particulars of performance may be made by one of the parties and the contract is binding if he acts in good faith and within commercial reasonableness.

This seems to conflict with the statement in Kirby v. Stokes County Bd. of Educ., 230 N.C. 619, 55 S.E.2d 322 (1949), that: "One of the essential elements of every contract is mutuality of agreement. There must be neither doubt nor difference between the parties. They must assent to the same thing in the same sense, and their minds must meet as to all the terms. If any portion of the proposed terms is not settled, or no mode agreed on which they may be settled, there is no agreement." Compare Richardson v. Greensboro Warehouse & Storage Co., 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

It would seem to be a question of materiality under prior North Carolina Law as to whether omitted terms of the contract might be supplied unilaterally by the parties or by the court.

CASE NOTES

Failure to Exercise Stock Option Within Reasonable Time. — Where plaintiffs could have availed themselves of the benefits of a stock option for over 17 months, which was more than a reasonable and seasonable amount of time within which to act, the trial judge properly concluded that plaintiffs had failed to exercise their option and could claim no ownership in the stock. Floto v. Pied Piper Resort, Inc., 96 N.C. App. 241, 385 S.E.2d 157, cert. denied, 326 N.C. 47, 389 S.E.2d 87 (1990).

§ 25-2-312. Warranty of title and against infringement; buyer's obligation against infringement.

(1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

(a) the title conveyed shall be good, and its transfer rightful; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications. (1965, c. 700, s. 1.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Editor's Note. — *This Amended Official Comment accompanies the revision to Article 9, effective July 1, 2001.*

Prior Uniform Statutory Provision: Section 13, Uniform Sales Act.

Changes: Completely rewritten, the provisions concerning infringement being new.

Purposes of Changes:

1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this Article requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith Section 2-725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of

infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this Article "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, certain foreclosing lienors and persons similarly situated may be so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

Foreclosure sales under Article 9 are another matter. Section 9-610 provides that a disposition of collateral under that section includes warranties such as those imposed by this section on a voluntary disposition of property of the kind involved. Consequently, unless properly excluded under subsection (2) or under the special provisions for exclusion in Section 9-610, a disposition under Section 9-610 of collateral consisting of goods includes the warranties imposed by subsection (1) and, if applicable, subsection (3).

6. The warranty of subsection (1) is not designated as an "implied" warranty, and hence is not subject to Section 2-316 (3). Disclaimer of the warranty of title is governed instead by subsection (2), which requires either specific language or the described circumstances.

Cross References:

Point 1: Section 2-403.
Point 2: Sections 2-607 and 2-725.
Point 3: Section 1-203.
Point 4: Sections 2-609 and 2-725.
Point 6: Section 2-316.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Person". Section 1-201.
"Right". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law that upon sale of a chattel the seller impliedly warrants that the seller has good title. Lanier v. Auld's Adm'r, 5 N.C. 138 (1806); Seymour v. W. S. Boyd Sales Co., 257 N.C. 603, 127 S.E.2d 265 (1960). In sales of personal property there is an implied warranty of good title upon the part of the vendor, and this warranty extends to and protects against liens, charges, and encumbrances by which the title is rendered imperfect and the value depreciated thereby.

Subsection (2): It is uncertain whether subsection (2) accords with prior North Carolina law. The question of whether a disclaimer of warranty operates to negate the implied warranty of title is expressly not decided in Seymour v. W. S. Boyd Sales Co., 257 N.C. 603, 127 S.E.2d 265 (1960). This UCC provision makes it clear that a warranty of title can be disclaimed or modified only by clear specific language or acts indicating a negation of the warranty. This accords with the general law of sales. See Vold, Sales 444.

Subsection (3) relating to warranty against infringement is new in North Carolina.

CASE NOTES

Burden on Plaintiffs Seeking Recovery on Warranty. — In an action to recover the price paid by plaintiffs to defendants for a tractor where plaintiffs alleged that the tractor was sold to satisfy a lien which existed at the time of the sale, summary judgment was improperly granted for the plaintiffs where they neither alleged nor offered evidentiary material to show that they had no knowledge of the existence of the lien, since the burden was on the plaintiffs, as movants, to produce evidence on every element necessary for them to prove in order to be entitled to judgment, and in order to recover on the warranty provided by this section, plaintiffs must prove the presence of a lien or encumbrance of which they had no knowledge. Smith v. Taylor, 44 N.C. App. 363, 261 S.E.2d 19 (1979).

Applied in MAS Corp. v. Thompson, 62 N.C. App. 31, 302 S.E.2d 271 (1983).

§ 25-2-313. Express warranties by affirmation, promise, description, sample.

(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 12, 14 and 16, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To consolidate and systematize basic principles with the result that:

1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied".

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and

described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under Section 2-316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1)(b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any affirmation of fact is intended to become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as describing values of the goods contracted for unless it is accompanied by an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (Section 2-209).

8. Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

Cross References:

Point 1: Section 2-316.
Point 2: Sections 1-102(3) and 2-318.
Point 3: Section 2-316(2) (b).
Point 4: Section 2-316.
Point 5: Sections 1-205(4) and 2-314.
Point 6: Section 2-316.
Point 7: Section 2-209.
Point 8: Section 1-103.

Definitional Cross References:

"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1)(a) accords with North Carolina's prior definition of express warranty. See Wrenn v. Morgan, 148 N.C. 101, 61 S.E. 641 (1908); Hodges v. Smith, 158 N.C. 256, 73 S.E. 807 (1912); Swift & Co. v. Meekins, 179 N.C. 173, 102 S.E. 138 (1920); Potter v. National Supply Co., 230 N.C. 1, 51 S.E.2d 908 (1949).

Subsection (1)(b) stating a warranty where a sale is by description accords with Swift & Co. v. Aydlett, 192 N.C. 330, 135 S.E. 141 (1926), and Lexington Grocery Co. v. Vernoy, 167 N.C. 427, 83 S.E. 567 (1914).

Subsection (1)(c) accords with Woodridge v. Brown, 149 N.C. 299, 62 S.E. 1076 (1908); Robertson v. Halton, 156 N.C. 215, 72 S.E. 316 (1911); Kime v. Riddle, 174 N.C. 442, 93 S.E. 946 (1917); Wrenn v. Morgan, 148 N.C. 101, 61 S.E. 641 (1908).

There will be no change in North Carolina law in connection with this section.

Cross References. — For the New Motor Vehicles Warranties Act, see G.S. 20-351 et seq.

Legal Periodicals. — For note on strict liability for breach of warranty, see 50 N.C.L. Rev. 697 (1972).

For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For comment on tort reform, see 10 Campbell L. Rev. 439 (1988).

For comment, "Laying the Ghost of Reliance to Rest in Section 2-313 of the Uniform Commercial Code: An 'Endpoints' Analysis," see 28 Wake Forest L. Rev. 1065 (1993).

CASE NOTES

Prior law is in accord with this section with respect to the creation of express warranties. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Subsections (1)(a) and (2) work no change in the pre-code law of North Carolina. Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

"Seller". — There is a substantial question as to whether it would be appropriate in light of G.S. 110(f) of the Federal Magnuson-Moss Warranty Act of 1975, 15 U.S.C. § 2301-2312, to interpret the word "seller" in this section to include a manufacturer (or anyone else) who issues an express warranty. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

Basic obligation created by description of goods cannot be retracted. — A clause generally disclaiming all warranties, express or implied, cannot reduce seller's obligation with respect to such description. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

When Privity Not Required. — Privity in the sale of goods is not necessary in a purchaser's action on a manufacturer's express warranty relating to the goods. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

The absence of contractual privity does not bar a direct claim by an ultimate purchaser against a manufacturer for breach of the manufacturer's express warranty which is directed to the purchaser. Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

A retailer may recover against the manufacturer for breach of warranty where a manufacturer's oral representations made directly to a retailer are intended to be communicated to remote buyers to induce them to buy a product. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Warranty to Buyer and User. — In an action by plaintiff buyer against defendant manufacturer under an express warranty which provides for a remedy in substitution for the general rule of damages applicable to breach of contract for sale of personal property, the remedy provided for in the express warranty is controlling, at least where such provision meets the general tests of legality. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

Where defendant obviously knew that buyer was seeking to obtain computer software on behalf of plaintiff, defendant made its express warranty to both plaintiff (buyer) and ultimate user of software in order to induce both parties to go through with the purchase of its software system. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Question of Fact. — Whether the parties to a transaction have created an express warranty is a question of fact. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982); Warren v. Joseph Harris Co., 67 N.C. App. 686, 313 S.E.2d 901 (1984).

The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Whether defendant made or breached any express warranties that scanner would completely perform quality scanning of human spine is question of fact to be decided by trier of fact. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Central Issue. — The single most important decision to make is whether the seller's statements were regarded by the buyer as part of his reason for purchasing the goods. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Issue of Material Fact as to Breach of Warranty. — Genuine issues of material fact existed as to owner's allegations of breach of express warranty; although manufacturer argued that it offered owner an express warranty which was rejected, architect and engineer for owner stated in his deposition that owner relied upon information and technical assistance by manufacturer in choosing the roof design and, therefore, owner's reliance would establish an express warranty by manufacturer. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989).

The seller's warranty is not his personal guarantee concerning the continuous and future operation of the goods which he has sold. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Neither Formal Words Nor Intent Are Necessary. — Neither the formal words of an express warranty nor the seller's intent to afford such a warranty is necessary to fulfill the requirements of this section. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Not All Statements by Seller Create Express Warranty. — The distinction between an affirmation or a description from mere sales talk or opinion or puffing is hazy. The law recognizes that some seller's statements are only sales palaver and not express warranties. Thus, expressions such as "supposed to last a lifetime" or "in perfect condition" do not create an express warranty. Hall v. T.L. Kemp Jewelry, Inc., 71 N.C. App. 101, 322 S.E.2d 7 (1984).

Statement as to Value Is Not Express Warranty. — A review of the case law of this State reveals no case where an opinion as to value, standing alone, was sufficient to amount to an express warranty. This does not necessarily mean that value could never become expressly warranted, but it suggests that in the ordinary course of business, a statement as to value is not considered an express warranty. Hall v. T.L. Kemp Jewelry, Inc., 71 N.C. App. 101, 322 S.E.2d 7 (1984).

Effect of Examination by Buyer. — An examination by the buyer of goods does not necessarily discharge the seller from an express warranty if the defect was one which could not be located by the buyer. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Secondhand goods may have an express warranty attached to them, and the warranty provisions are applied without regard to whether the seller is a manufacturer, merchant, or farmer. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Under the following circumstances, defendants expressly warranted that, at the time of the sale, a used tractor was in good condition and free from major mechanical defects: (1) Defendants had superior knowledge of the subject matter; (2) the circumstances were such that the plaintiff, as a reasonable man, was entitled to rely on the defendants' statements; and (3) the statements were a part of the basis of the bargain. Pake v. Byrd, 55 N.C. App. 551, 286 S.E.2d 588 (1982).

Statement Held Mere Opinion. — Seller's statement that a mobile home "was supposed to last a lifetime and be in perfect condition" is merely an expression of opinion and does not create an express warranty. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Statement made by salesman to farmer that a certain herbicide would "do a good job" was a mere expression of opinion and did not create an express warranty. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Statement Held to Be "Puffing". — Seller's advertisement that it sold "America's most complete line of reliable, economical gas heating appliances" was, under the Uniform Commercial Code, "a statement purporting to be merely the seller's opinion or commendation of the goods does not create warranty." Seller's statement that the heater was "reliable" could not be regarded by the buyers as part of the reason for their purchase; therefore, the language in seller's advertisement was mere puffing and not an express warranty. Warzynski v. Empire Comfort Sys., 102 N.C. App. 222, 401 S.E.2d 801 (1991).

Statement by Seller Creating Express Warranty. — In letter, president of defendant corporation stated, "We guarantee our programming with full return and refund privileges for the software and printer should our programming not perform as warranted." As a matter of law, this letter constituted an express warranty that the equipment would perform correctly. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Where plaintiffs were informed by defendant's sales agent that their car was subject to a 12-month, 12,000 mile warranty, such a statement was certainly an affirmation of fact relating to the goods which became a basis of the bargain, and plaintiffs had no way of determining that such a warranty was limited to the manufacturer because there was no evidence that plaintiffs were told it was a manufacturer's warranty or that defendant excluded itself from the warranty and they were not even given a written copy of the warranty. The evidence supported the trial court's conclusion that defendant had made an express warranty to plaintiffs. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Breach of Express Warranty Shown. — Evidence was sufficient to support a finding by the jury that defendant breached an express warranty, where plaintiff testified at trial that defendant told him that certain engine parts on the car which he purchased had been replaced within six months, while testimony of an employee of defendant that he had replaced these parts approximately "a year and a half" before the sale was uncontroverted. Bailey v. LeBeau, 79 N.C. App. 345, 339 S.E.2d 460, modified and aff'd, 318 N.C. 411, 348 S.E.2d 524 (1986).

Breach of Express Warranty Not Shown. — In action for damages resulting from aircraft crash, plaintiffs-air passengers contended that they were third-party beneficiaries of an alleged express or implied warranty existing between aircraft manufacturer and preparer of negligently prepared and published aircraft instruction manual and aircraft pilot; however, plaintiffs did not allege that any relationship of the type required by this section existed at the time of the crash. Therefore, plaintiffs were not entitled to relief based upon their theories as a matter of law. Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993).

Applied in Helson's Premiums & Gifts, Inc. v. Duncan, 9 N.C. App. 653, 177 S.E.2d 428 (1970); HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974); Potter v. Tyndall, 22 N.C. App. 129, 205 S.E.2d 808 (1974); Hobson Constr. Co. v. Hajoca Corp., 28 N.C. App. 684, 222 S.E.2d 709 (1976); Coffer v. Standard Brands, Inc., 30 N.C. App. 134, 226 S.E.2d 534 (1976); ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976); Byrd Motor Lines v. Dunlop Tire & Rubber Corp., 63 N.C. App. 292, 304 S.E.2d 773 (1983); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Russel v. Baity, 95 N.C. App. 422, 383 S.E.2d 217 (1989); Bryant v. Adams, 116 N.C. App. 448, 448 S.E.2d 832 (1994); McDonald Bros., Inc. v. Tinder Wholesale, LLC, 395 F. Supp. 2d 255, 2005 U.S. Dist. LEXIS 25446 (M.D.N.C. 2005).

Cited in Griffin v. Wheeler-Leonard & Co., 290 N.C. 185, 225 S.E.2d 557 (1976); Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282 (1979); McNair Constr. Co. v. Fogle Bros. Co., 64 N.C. App. 282, 307 S.E.2d 200 (1983).

§ 25-2-314. Implied warranty: Merchantability; usage of trade.

(1) Unless excluded or modified (G.S. 25-2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (G.S. 25-2-316) other implied warranties may arise from course of dealing or usage of trade. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15(2), Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of Section 2-316). Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in Section 15(2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee".

5. The second sentence of subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be consumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in subsections (1) and (2)(c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as . . . ," and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but the goods are not "fair average" if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary and merchantable goods must therefore be "honestly" resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a reminder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction requires a certain type of container, package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra

consideration arises in this connection since, under this Article, an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under Section 2-316. A typical instance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

Cross References:

Point 1: Section 2-316.
Point 3: Sections 1-203 and 2-104.
Point 5: Section 2-315.
Point 11: Section 2-316.
Point 12: Sections 1-201, 1-205 and 2-316.

Definitional Cross References:

"Agreement". Section 1-201.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Merchant". Section 2-104.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1): The first sentence of subsection (1), implying warranty of merchantability that personal property is merchantable and reasonably fit for the purposes for which sold, accords with prior North Carolina law. See Aldridge Motors v. Alexander, 217 N.C. 750, 9 S.E.2d 469 (1940); Swift & Co. v. Aydlett, 192 N.C. 330, 135 S.E. 141 (1926); Continental Jewelry Co. v. Stanfield, 183 N.C. 10, 110 S.E. 585 (1922); Ashford v. H. C. Shrader Co., 167 N.C. 45, 83 S.E. 29 (1914); Shoop Family Medicine Co. v. Davenport, 163 N.C. 294, 79 S.E. 602 (1913).

The second sentence of subsection (1) negates the possibility of argument that a restaurateur merely "utters a service" and does not make a "sale." This argument had been upheld in a bulk sales case in Swift & Co. v. Tempelos, 178 N.C. 487, 101 S.E. 8 (1919), but expressly was not decided in Williams v. Elson, 218 N.C. 157, 10 S.E.2d 668 (1940), in a food warranty case. The UCC makes restaurants liable for "sales" whether the food served is to be consumed on or off the premises. It clarifies a point that may have been questionable under prior law. This can be quite important in North Carolina because of the practical nonavailability of the doctrine of res ipsa loquitur in negligence actions, often necessitating resort to warranty actions when proof of negligence is not available.

Subsection (2) accords with prior North Carolina law in general but spells out in detail the requirements of "merchantability." North Carolina's definition of merchantability under prior law is set out in Swift & Co. v. Aydlett, 192 N.C. 330, 135 S.E. 141 (1926): "A vendor of an article of personal property, by name and description, cannot relieve himself of the obligation arising from the warranty implied by law to deliver an article which is at least merchantable, or saleable or fit for the use of which articles of that name and description are ordinarily sold and bought."

Note that the section only applies when the seller is a merchant.

Cross References. — For the New Motor Vehicles Warranties Act, see G.S. 20-351 et seq. As to the Childhood Vaccine-Related Injury Compensation Program, see G.S. 130A-422 et seq.

Legal Periodicals. — For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For survey of 1972 case law on recovery for personal injury under implied warranty, see 51 N.C.L. Rev. 1159 (1973).

For survey of 1976 case law on commercial law, see 55 N.C.L. Rev. 943 (1977).

For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For note on farmers as merchants Under the Uniform Commercial Code, see 1 Campbell L. Rev. 141 (1979).

For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For article, "North Carolina's New Products Liability Act: A Critical Analysis," see 16 Wake Forest L. Rev. 171 (1980).

For survey of 1980 commercial law, see 59 N.C.L. Rev. 1084 (1981).

For comment, "The Crashworthy Vehicle: Heading for a Collision in the North Carolina Courts," see 18 Wake Forest L. Rev. 711 (1982).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For comment on tort reform, see 10 Campbell L. Rev. 439 (1988).

For survey, "Contract Warranties and Remedies: A Comprehensive Survey of the Creation, Modification and Exclusion of Contract Warranties and Remedies for Attorneys and Contracting Professionals," see 14 Campbell L. Rev. 323 (1993).

For article, "Products Liability — Emerging Consensus and Persisting Problems: An Analytical Review Presenting Some Options," 25 Campbell L. Rev. 1 (2002).

CASE NOTES

This section accords with prior law. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

The requirements of "merchantability" spelled out in detail in subsection (2) include the prior case law definition that the personal property must be reasonably fit for the purposes for which sold. Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976).

Section Restricts Application of Doctrine of Caveat Emptor. — The common-law doctrine of caveat emptor historically applied to sales of both real and personal property. Its application to personal property sales, however, has been restricted by this section. Hinson v. Jefferson, 287 N.C. 422, 215 S.E.2d 102 (1975).

Warranties Arise under the Uniform Commercial Code only upon a sale of goods. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Action for breach of implied warranty of merchantability is established by G.S. 25-2-314 of the North Carolina Uniform Commercial Code and is a product liability action within the meaning of the Products Liability Act, G.S. 99B-1 et seq., if the action is for injury to a person resulting from a sale of a product. DeWitt v. Eveready Battery Co., 355 N.C. 672, 565 S.E.2d 140, 2002 N.C. LEXIS 548 (2002).

Sale by Merchant Gives Rise to Warranty. — Where seller was a merchant with respect to the sale of mobile homes, and the security agreement executed by buyer contained no language, as permitted by G.S. 25-2-316, excluding or modifying the implied warranty of merchantability, the sale carried with it an implied warranty that the mobile home was fit for the residential purposes for which such goods are ordinarily used. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Completed Delivery Constitutes Sale. — If there has been a completed delivery by the seller, the sale has been consummated and implied warranties arise under this section. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Merchantability Determined as of Time of Sale. — Plaintiffs argument that warnings were not sufficient because they had faded from exposure to the weather by the time plaintiff jumped on the trampoline was problematic as the warnings were there at the time of sale and for recovery under implied warranty of merchantability the product must be unmerchantable at the time of sale. Bryant v. Adams, 116 N.C. App. 448, 448 S.E.2d 832 (1994), cert. denied, 339 N.C. 736, 454 S.E.2d 647 (1995).

Merchantability Determined Time of Sale. — Where a worker sued a clamp manufacturer after the worker was injured when a clamp failed on an irrigation system, the trial court properly directed a verdict in favor of the manufacturer on the worker's claim that the manufacturer breached the implied warranty of merchantability under G.S. 25-2-314 where the worker failed to produce substantial evidence tending to establish that the clamp was defective at the time of sale, especially since the worker's evidence did not eliminate other possible causes of the accident and the worker's expert admitted that the clamp did not violate any industry standards and would have passed as merchantable in the industry. Evans v. Evans, 153 N.C. App. 54, 569 S.E.2d 303, 2002 N.C. App. LEXIS 1082 (2002), cert. denied, 356 N.C. 670, 577 S.E.2d 296 (2003).

The implied warranty of merchantability applies equally to both the retailer and the manufacturer of goods. Gillispie v. Thomasville Coca-Cola Bottling Co., 17 N.C. App.

545, 195 S.E.2d 45, cert. denied, 283 N.C. 393, 196 S.E.2d 275 (1973).

Retailer Entitled to Indemnification. — While restaurant's breach of warranty of merchantability was separate and distinct from seafood supplier's breach of the warranty of merchantability, in accordance with the jury instructions, only one such breach was necessary to cause patron's death as a result of scromboid fish poisoning. Accordingly, the restaurant, having committed the secondary breach, was entitled to indemnification from the primary obligor, the seafood supplier, as a matter of law. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

Summary Judgment Inappropriate in Water Quality Case. — Where a laundry owner sued a town regarding dirty water, summary judgment was inappropriate as to the owner's claim for breach of the implied warranty of merchantability because: (1) without being able to inspect the water prior to purchase, the owner could not determine whether the water was fit for use; and (2) under G.S. 1-53, the owner could sue for any damages that occurred within two years prior to filing the lawsuit. Jones v. Town of Angier, — N.C. App. —, 638 S.E.2d 607, 2007 N.C. App. LEXIS 67 (2007).

But Not to One Who Merely Allows Seal of Inspection to Be Placed on Product. — This section and G.S. 25-2-315 are not applicable to one that simply allows its seal of inspection to be placed on a product manufactured by someone else. Any implied warranty in such a case would concern the quality of inspection services rather than the quality of goods. Jones v. Clark, 36 N.C. App. 327, 244 S.E.2d 183 (1978).

Physician Issuing Prescription Not a "Seller". — The physician who issues a prescription for an oral contraceptive drug is not a "seller" within the meaning of this section and the issuance of the prescription does not constitute passing title. Batiste v. American Home Prods. Corp., 32 N.C. App. 1, 231 S.E.2d 269, cert. denied, 292 N.C. 466, 233 S.E.2d 921 (1977).

State and Federal Regulatory Acts Aid in Assessing Merchantability. — In assessing the merchantability of goods under subsections (2)(a) through (f), various state and federal regulatory acts are instructive. This is especially pertinent in regard to a determination of merchantability under subsection (2)(a) and (c). Coffer v. Standard Brands, Inc., 30 N.C. App. 134, 226 S.E.2d 534 (1976).

Fact that hamburger complied with all state and federal regulations for ground beef did not establish that the meat was merchantable as a matter of law, but was only some evidence which the jury could consider in determining if the product was merchantable. Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Disclaimer and Substitution of § 25-2-719 (1)(a) Limitations. — A merchant seller may disclaim all liability under G.S. 25-2-316(2) stemming from any breach of warranties of merchantability and fitness under G.S. 25-2-315 and this section, substituting in place thereof the limitations of G.S. 25-2-719(1)(a). Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

Strict Liability in Tort Compared. — Strict liability in tort is a substantially more narrow basis of liability than breach of implied warranty of merchantability under subsection (1). Coffer v. Standard Brands, Inc., 30 N.C. App. 134, 226 S.E.2d 534 (1976).

Implied Warranty of Restaurant. — Generally, a restaurant makes an implied warranty that the food which it serves is fit for human consumption, even though the restaurant in the exercise of all possible care could not have discovered its unwholesome nature. Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Natural Substance in Food. — When a substance in food causes injury to a consumer of the food, it is not a bar to recovery for breach of applied warranties of merchantability against the seller that the substance was "natural" to the food, provided the substance is of such a size, quality or quantity, or the food has been so processed, or both, that the substance's presence should not reasonably have been anticipated by the consumer. Goodman v. Wenco Foods, Inc., 331 N.C. 1, 423 S.E.2d 444 (1992).

Statement Constituting Express Warranty. — In letter, president of defendant corporation stated, "We guarantee our programming with full return and refund privileges for the software and printer should our programming not perform as warranted." As a matter of law, this letter constituted an express warranty that the equipment would perform correctly. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity Not Required. — Absence of contractual privity no longer bars a direct claim by an ultimate purchaser against the manufacturer for breach of the manufacturer's express warranty which is directed to the purchaser. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity is not required when the theory is breach of an express warranty. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity Not Abolished for Employees. — A buyer's employee is barred from suit against a seller grounded upon breach of implied warranty in that neither the Act nor the U.C.C. provisions regarding implied warranties abolish the privity requirement in such instance. Nicholson v. American Safety Util. Corp., 124 N.C. App. 59, 476 S.E.2d 672, 1996 N.C. App. LEXIS 1016 (1996), cert. granted, 483 S.E.2d 173 (1997), cert. granted, 483 S.E.2d 174 (1997), modified and aff'd, 346 N.C. 767, 488 S.E.2d 240 (1997).

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Express Warranty Made to Plaintiff Buyer and Ultimate User. — Where defendant obviously knew that buyer was seeking to obtain computer software on behalf of plaintiff, defendant made its express warranty to both plaintiff (buyer) and ultimate user of software in order to induce both parties to go through with the purchase of its software system. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

The action for breach of the implied warranty of merchantability is akin to the action of strict liability in tort, except that proof of negligence and foreseeability of injury are not required. It is also akin to a contract action, except that privity requirements have become considerably more relaxed by the various courts in recent years and, further, affirmative defenses of disclaimer and failure to give timely notice may be asserted by the seller. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

What Plaintiff Must Show. — In its pure form, an action for breach of implied warranty of merchantability under this section entitles a plaintiff to recover without any proof of negligence on a defendant's part where it is shown that (1) a merchant sold goods, (2) the goods were not "merchantable" at the time of sale, (3) the plaintiff (or his property) was injured by such goods, (4) the defect or other condition amounting to a breach of the implied warranty of merchantability proximately caused the injury, and (5) the plaintiff so injured gave timely notice to the seller. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980), aff'd in part and rev'd in part, 302 N.C. 129, 273 S.E.2d 681 (1981).

Five elements must be proved in order to support a recovery under this section: (1) A merchant sold goods, (2) the goods were not "merchantable" at the time of sale, (3) the plaintiff was injured by such goods, (4) the defect or other condition amounting to a breach of the implied warranty of merchantability proximately caused the injury, and (5) the plaintiff so injured gave timely notice to the seller. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987).

Under this section, a plaintiff must prove: first, that the goods bought and sold were subject to an implied warranty of merchantability; second, that the goods did not comply with the warranty in that the goods were defective at the time of sale; third, that his injury was due to the defective nature of the goods; and fourth, that damages were suffered as a result. Cockerham v. Ward, 44 N.C. App. 615, 262 S.E.2d 651, cert. denied, 300 N.C. 195, 269 S.E. 622 (1980); Morrison v. Sears, Roebuck & Co., 80 N.C. App. 224, 341 S.E.2d 40 (1986); Chandler v. U-Line Corp., 91 N.C. App. 315, 371 S.E.2d 717, cert. denied, Bank of United States v. Cuthbertson, 67 F.2d 182 (4th Cir. 1933).

To present a prima facie case of breach of implied warranty under this section plaintiff must produce any evidence more than a scintilla (1) that an implied warranty covered the goods in question, (2) that the seller breached the warranty in that the goods were not merchantable at the time of sale, and (3) that the breach proximately caused the injury and loss sustained by plaintiff. Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981).

The burden is upon the purchaser to establish a breach by the seller of the warranty of merchantability by showing that a defect existed at the time of the sale. Morrison v. Sears, Roebuck & Co., 80 N.C. App. 224, 341 S.E.2d 40, rev'd on other grounds, 319 N.C. 298, 354 S.E.2d 495 (1986).

The attributes listed in subsection (2) are not exclusive nor exhaustive. Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980), aff'd in part and rev'd in part, 302 N.C. 129, 273 S.E.2d 681 (1981).

Product Liability Act Available as Defense. — The legislature intended that G.S. 99B-2(a), a part of the Products Liability Act, be available as a defense to actions for breach of an implied warranty of merchantability brought under the UCC. Morrison v. Sears, Roebuck & Co., 319 N.C. 298, 354 S.E.2d 495 (1987).

Where defendant distributors acquired and sold potato whitener in sealed cartons and there was no evidence that they damaged, mishandled or otherwise altered the product, and defendant food service obtained the product in sealed jars and no evidence demonstrated that they damaged or altered the product, G.S. 99B-2(a) barred recovery on plaintiff's implied warranty claims against food service, (plaintiff's employer) and the distributors. Sutton v. Major Prods. Co., 91 N.C. App. 610, 372 S.E.2d 897 (1988).

Compliance of vaccine manufacturer with Food and Drug Administration standards did not dictate a per se finding that DPT vaccine was "merchantable" at the time of sale. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987). As to vaccine-related injuries, see now § 130A-422 et seq.

Damages for Breach. — Where there is breach of the implied warranty of merchantability the UCC provides for recovery by the buyer of both "general" damages, which are implied by law, and "special" damages, which arise from the special circumstances of the case and must be properly pleaded. Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976).

Extent of Warranty of Fitness. — The warranty of fitness, either express or implied, is contractual and the contract extends no further than the parties to it and their privies. Privity to the contract is the basis of liability. Gillispie v. Thomasville Coca-Cola Bottling Co., 17 N.C. App. 545, 195 S.E.2d 45, cert. denied, 283 N.C. 393, 196 S.E.2d 275 (1973).

Pre-Code Warranty Excluded Containers. — Before adoption of the UCC an implied warranty of fitness did not extend to a container in which a product came from the producer. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Sale of Food or Drink. — The sale of food or drink constitutes a sale of goods, and a warranty of merchantability is implied in all contracts for the sale of goods. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

Code Extends Implied Warranty to Include Containers. — An implied warranty of fitness has been extended by the UCC to include a product's container. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

And Injury Caused by Container Constitutes Breach. — The fact that it is the container, rather than the product inside, which causes injury, does not make the injury any less a result of the seller's breach of warranty. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Under this section, soft drinks are not merchantable if inadequately contained. — If they are sold in a container which is inadequate, the seller has breached his implied warranty of merchantability and he is liable for personal injury proximately caused by this breach. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

The instructions accompanying product may be integral part of warranty. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

Unmerchantable Automobile. — When plaintiff's evidence indicated he had returned the car to defendant for repairs on at least six occasions during the first six months of his ownership, and that plaintiff had driven the car a total of only 700 miles before he was informed the car was not repairable, plaintiff's evidence demonstrated that the car was unfit for its ordinary purpose at the time of the sale and was therefore "unmerchantable" at that time. Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992).

Failure to Warn of Dangerous Propensities May Render Product Unmerchantable. — When an aerosol deodorant can is viewed holistically, and especially where dangerous propensities under specified conditions inhere to both container and contents as well as their several interfaces, a failure to adequately warn of all such propensities may, in a proper case, render a product unmerchantable under subdivisions (2)(c), (e) and (f) of this section and provide grounds for an action to recover damages for breach of the implied warranty of merchantability embodied in subsection (1) of this section. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

Breach of Warranty as to Aerosol Deodorant. — Where an aerosol can of deodorant was being used for its intended purposes in a normal way, the expectation of the consumer that the product if used according to furnished instructions, would not injure him was found to lie within the warranty of fitness for ordinary purposes of subdivision (2)(c) of this section. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

Where the plaintiff used an aerosol can of deodorant in accordance with its directions and warnings, set the can down, walked across the room and lit his cigarette, simultaneously igniting the alcohol in the deodorant he had applied to himself, his cause of action, contending that he was given insufficient notice of the natural propensities of the product as it was constituted and that the label contained insufficient data from which he reasonably could have inferred any danger of what in fact occurred, was cognizable under a theory of breach of the implied warranty of merchantability under this section. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

Where a grantor conveys land subject to restrictive covenants that limit its use to the construction of a single-family dwelling, and, due to subsequent disclosures, both unknown to and not reasonably discoverable by the grantee before or at the time of conveyance, the property cannot be used by the grantee, or by any subsequent grantees through mesne conveyances, for the specific purpose to which its use is limited by the restrictive covenants, the grantor breaches an implied warranty arising out of said restrictive covenants. Hinson v. Jefferson, 287 N.C. 422, 215 S.E.2d 102 (1975).

Distributor Must Disclose Limitation on Warranty. — Where the manufacturer gave ample warning to the distributor who failed to pass it on to the consumer, and the distributor selected the product, unqualifiedly recommended it, and sold it for immediate use, then in the absence of express warranty on the part of the manufacturer, the implied warranty of limited fitness between the manufacturer and the distributor placed the primary responsibility on the distributor to notify the user of the limitation on fitness. Wilson v. E-Z Flo Chem. Co., 281 N.C. 506, 189 S.E.2d 221 (1972).

Retailer Liable for Breach May Recover from Manufacturer. — Where the retailer purchases personal property from the manufacturer or wholesaler for resale with implied or express warranty of fitness and the retailer resells to the consumer with the same warranty and the retailer has been compelled to pay for breach of warranty, he may recover his entire loss from the manufacturer. This rule is not applicable between the manufacturer who gave warning and the distributor who has been warned, but fails to pass on the warning to the user. Wilson v. E-Z Flo Chem. Co., 281 N.C. 506, 189 S.E.2d 221 (1972).

Where the retailer purchases personal property from the manufacturer for resale with implied or express warranty of fitness and the retailer resells to the consumer with the same warranty and the retailer has been compelled to pay for breach of warranty, he may recover his entire loss from the manufacturer. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

Proof of compliance with government standards is no bar to recovery on a breach of warranty theory. Although such evidence may well be pertinent to the issue of the existence of a breach of any warranty, it is not conclusive. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

Acceptance of Product Held Not to Bar Action. — While the purchaser of a mobile home was obligated to pay the contract price when she paid the loan on the home and released the lender, thereby accepting the home and barring rejection, she could still maintain an action for breach of warranty. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

Merchantability Held Question for Jury. — Whether an aerosol can of deodorant, when viewed as a whole (including contents, packaging, labeling and warnings) was merchantable was a jury question not susceptible of summary adjudication on the basis of the labeling of the product. Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344, cert. denied, 297 N.C. 612, 257 S.E.2d 219 (1979).

A defendant is entitled to have his counterclaim, based upon a breach of implied warranty of merchantability, submitted to a jury unless the contract contains an exclusion or modification of the implied warranty. Trio Estates, Ltd. v. Dyson, 10 N.C. App. 375, 178 S.E.2d 778 (1971).

Where the defective product, a flashcube, was enclosed in its original container until use and nothing occurred between the purchase and use of the product which would indicate that plaintiff mishandled, damaged or altered the product, the evidence did not compel a finding that the product was not merchantable at the time of sale but the evidence was sufficient to permit a reasonable inference to the effect that the flashcube was not merchantable at the time of sale, and therefore, it was a matter of fact for the jury to decide and not a matter of law for the trial court. Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980), aff'd in part and rev'd in part, 302 N.C. 129, 273 S.E.2d 681 (1981).

The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Expectation of Defect Held Question for Jury. — Whether the defect should reasonably be expected by the ordinary consumer is usually a question for the jury. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

Warranties Based on Contractual Theory. — Where plaintiff buyer brought an action to recover for a defective boat manufactured by defendant, there was no basis for plaintiff's claims of breach of implied warranty of merchantability and breach of implied warranty of fitness for a particular purpose, since those implied warranties are based on contractual theory, and there was no privity of contract between plaintiff buyer and defendant manufacturer. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

Burden of Proof. — In order to effectively assert a claim under this section, the plaintiff must prove the giving of the warranty, the breach of that warranty, and damages resulting to him as a proximate result of the breach. Burbage v. Atlantic Mobilehome Suppliers Corp., 21 N.C. App. 615, 205 S.E.2d 622 (1974).

The burden is upon the buyer to establish a breach by the seller of the warranty of merchantability; that is, to show that the defect existed at the time of the sale. Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975); Cockerham v. Ward, 44 N.C. App. 615, 262 S.E.2d 651, cert. denied, 300 N.C. 195, 269 N.C. 622 (1980).

No Right of Contribution for Third Party. — Claim for relief, based on a breach of implied warranty, gave rise to no right of contribution on the part of third party plaintiff, because it sounded in contract and not in tort. Holland v. Edgerton, 85 N.C. App. 567, 355 S.E.2d 514 (1987).

No Implied Warranty of Fitness for Particular Purpose Applied when Manufactured to Buyer's Specification. — Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

Summary Judgment Inappropriate in Light Fixture Case. — Genuine issues of material fact regarding whether a fluorescent light fixture and ballast were fit for the ordinary purpose for which such goods are used supported a claim of products liability based on breach of implied warranty of merchantability. There was evidence from plaintiff's expert and investigators that the fire that destroyed the mill originated at the suspect fluorescent light fixture and was caused by the ballast, even though they could not point to a specific defect within the ballast. Red Hill Hosiery Mill v. Magnetek, Inc., 138 N.C. App. 70, 530 S.E.2d 321, 2000 N.C. App. LEXIS 542 (2000).

No Issue of Material Fact as to Breach of Implied Warranties. — There were no genuine issues of material fact for supplier's negligence and breach of implied warranty of merchantability where supplier provided neither technical assistance nor installation training and instruction to subcontractor, and no evidence on appeal showed that manufacturer's materials were in any way defective. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 375 (1989).

Applied in Hobson Constr. Co. v. Hajoca Corp., 28 N.C. App. 684, 222 S.E.2d 709 (1976); Angola Farm Supply & Equip. Co. v. FMC Corp., 59 N.C. App. 272, 296 S.E.2d 503 (1982); Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988); Russel v. Baity, 95 N.C. App. 422, 383 S.E.2d 217 (1989); Lormic Dev. Corp. v. North Am. Roofing Co., 95 N.C. App. 704, 383 S.E.2d 694 (1989); Dewitt v. Eveready Battery Co., 144 N.C. App. 143, 550 S.E.2d 511, 2001 N.C. App. LEXIS 432 (2001), cert. denied, 354 N.C. 216, 553 S.E.2d 398 (2001), aff'd, 355 N.C. 672, 565 S.E.2d 140 (2002); McDonald Bros., Inc. v. Tinder Wholesale, LLC, 395 F. Supp. 2d 255, 2005 U.S. Dist. LEXIS 25446 (M.D.N.C. 2005).

Cited in Stiles v. Chloride, Inc., 668 F. Supp. 505 (W.D.N.C. 1987); Ferguson v. Williams, 92 N.C. App. 336, 374 S.E.2d 438 (1988); Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992); Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 415 S.E.2d 574 (1992); McCorkle v. Aeroglide Corp., 115 N.C. App. 651, 446 S.E.2d 145 (1994).

§ 25-2-315. Implied warranty: Fitness for particular purpose.

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section [G.S. 25-2-316] an implied warranty that the goods shall be fit for such purpose. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15 (1), (4), (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes:

1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of

the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this Article on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this Article on the allocation or division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with certain laws or regulations. How the risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to non-merchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this Article. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is to call attention to the possibility of eliminating the warranty in any given case. However, it must be noted that under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

Cross References:

Point 2: Sections 2-314 and 2-317.
Point 3: Section 2-303.
Point 6: Section 2-316.

Definitional Cross References:

"Buyer". Section 2-103.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section accords with Stokes v. Edwards, 230 N.C. 306, 52 S.E.2d 797 (1949); Southern Box & Lumber Co. v. Home Chair Co., 250 N.C. 71, 108 S.E.2d 70 (1959).

Cross References. — For the New Motor Vehicles Warranties Act, see G.S. 20-351 et seq. As to the Childhood Vaccine-Related Injury Compensation Program, see G.S. 130A-422 et seq.

Legal Periodicals. — For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For survey of 1981 commercial law, see 60

N.C.L. Rev. 1238 (1982).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For note, "The Legal Liability of Blood Donor Services and Transfusion Providers in the Wake of the AIDS Crisis," see 290 N.C. Cent. L.J. 20 (1992).

For survey, "Contract Warranties and Remedies: A Comprehensive Survey of the Creation, Modification and Exclusion of Contract Warranties and Remedies for Attorneys and Contracting Professionals," see 14 Campbell L. Rev. 323 (1993).

CASE NOTES

This section did not repeal or limit the scope of former § 106-50.7(e)(4), since G.S. 25-2-102 provides that the Uniform Commercial Code does not "impair or repeal any statute regulating sales to . . . farmers." Potter v. Tyndall, 22 N.C. App. 129, 205 S.E.2d 808, cert. denied, 285 N.C. 661, 207 S.E.2d 762 (1974).

This section and § 25-2-314 are not applicable to one who simply allows his seal of inspection to be placed on a product manufactured by someone else. Any implied warranty in such a case would concern the quality of inspection services rather than the quality of goods. Jones v. Clark, 36 N.C. App. 327, 244 S.E.2d 183 (1978).

Inapplicable to Lease. — Agreement between the parties providing for the lease of golf carts, which agreement was designated a lease on its face and was for a fixed term of 48 months, also provided the lessee with the option to purchase the golf carts. This purchase option indicated that the parties intended to engage in a true lease, not a disguised sale because the option price was the equipment's fair market value, and the purchase option was intended to approximate the depreciated fair market value of the golf carts. The agreement was therefore a true lease, making Article 2 inapplicable. Beau Rivage Plantation, Inc. v. Melex USA, Inc., 112 N.C. App. 446, 436 S.E.2d 152 (1993).

Distributor Must Disclose Limitation on Warranty. — Where the manufacturer gave ample warning to the distributor who failed to pass it on to the consumer, and the distributor selected the product, unqualifiedly recommended it, and sold it for immediate use, then in the absence of express warranty on the part of the manufacturer, the implied warranty of limited fitness between the manufacturer and the distributor placed the primary responsibility on the distributor to notify the user of the limitation on fitness. Wilson v. E-Z Flo Chem. Co., 281 N.C. 506, 189 S.E.2d 221 (1972).

Abrogation of Privity Requirement in Certain Claims. — Chapter 99B (products liability) expressly abrogates the privity requirement in certain claims based upon implied warranty. However, outside the exceptions created by Chapter 99B, the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Disclaimer and Substitution of § 25-2-719(1)(a) Limitations. — A merchant seller may disclaim all liability under G.S. 25-2-316(2) stemming from any breach of warranties of merchantability and fitness under G.S. 25-2-314 and this section, substituting in place thereof the limitations of G.S. 25-2-719(1)(a). Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

Acceptance of Product Held Not to Bar Action. — While the purchaser of a mobile home was obligated to pay the contract price when she paid the loan on the home and released the lender, thereby accepting the home and barring rejection, she could still maintain an action for breach of warranty. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

Defect Must Have Existed at Time of Sale. — The seller's warranty is not his personal guarantee regarding the continuous and future operation of the goods which he has sold. To establish a breach of warranty, there must be evidence sufficient to show that the defect existed at the time of the sale. Bailey v. LeBeau, 79 N.C. App. 345, 339 S.E.2d 460, modified and aff'd, 318 N.C. 411, 348 S.E.2d 524 (1986).

Where no evidence was introduced to show that car's breakdown was caused by any defect that existed at the time of its sale, the issue of breach of implied warranty of fitness for the particular purpose of long distance driving should not have been submitted to the jury. Bailey v. LeBeau, 79 N.C. App. 345, 339 S.E.2d 460, modified and aff'd, 318 N.C. 411, 348 S.E.2d 524 (1986).

Ordinary use of product precludes recovery. — Ordinary use of a product forecloses recovery under the implied warranty of fitness for a particular purpose; therefore, a retailer of building products and materials was unable to proceed on its claim against a supplier of lumber products for breach of the implied warranty of fitness for a particular purpose because the finger-jointed trim boards for use in home construction that formed the basis of the complaint had been put to their ordinary use. McDonald Bros., Inc. v. Tinder Wholesale, LLC, 395 F. Supp. 2d 255, 2005 U.S. Dist. LEXIS 25446 (M.D.N.C. 2005).

Retailer Liable for Breach May Recover from Manufacturer. — Where the retailer purchases personal property from the manufacturer or wholesaler for resale with implied or express warranty of fitness and the retailer resells to the consumer with the same warranty and the retailer has been compelled to pay for breach of warranty, he may recover his entire loss from the manufacturer. This rule is not applicable between the manufacturer who gave warning and the distributor who has been warned, but fails to pass on the warning to the user. Wilson v. E-Z Flo Chem. Co., 281 N.C. 506, 189 S.E.2d 221 (1972).

Where the retailer purchases personal property from the manufacturer for resale with implied or express warranty of fitness and the retailer resells to the consumer with the same warranty and the retailer has been compelled to pay for breach of warranty, he may recover his entire loss from the manufacturer. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

Warranties Based on Contractual Theory. — Where plaintiff buyer brought an action to recover for a defective boat manufactured by defendant, there was no basis for plaintiff's claims of breach of implied warranty of merchantability and breach of implied warranty of fitness for a particular purpose, since those implied warranties are based on contractual theory, and there was no privity of contract between plaintiff buyer and defendant manufacturer. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

Question of Fact. — The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Sale of Camper with Defective Motor Held Breach. — Defendants made and breached the implied warranty of fitness, where they sold a camper to plaintiffs with a motor which was warranted as a new motor but failed to perform and had to be replaced one month after purchase. Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

Purpose of Vaccine. — DPT vaccine had the ordinary purpose of preventing the contraction of disease. There was no particular purpose, native to the plaintiff's position, that would implicate an implied warranty for a particular purpose. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987). As to vaccine-related injury, see now § 130A-422 et seq.

Evidence Held to Show Implied Warranty. — Evidence was sufficient for jury to find that salesman, consulted by farmer with regard to the no-till cultivation of soybeans, made an implied warranty relating to the fitness of a certain herbicide for plaintiff's purpose and that this warranty was breached. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Evidence of Damages Insufficient. — A warranty action failed for lack of evidence of damages proximately resulting from defects at the time of sale some 17 months and 30,000 miles earlier. Cooper v. Mason, 14 N.C. App. 472, 188 S.E.2d 653 (1972).

No Implied Warranty of Fitness for Particular Purpose Applied When Manufactured to Buyer's Specifications. — Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

Supplier Not Liable Where Owner Relied on Manufacturer. — There was no genuine issue of material fact as to breach of implied warranty of particular purpose where owner did not rely in any way upon supplier's advice in owner's selection of the roofing system, but rather, it was manufacturer whom owner relied upon. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 375 (1989).

For case involving the sale of prescription drugs, i.e., birth control pills, as it relates to this section, see Batiste v. American Home Prods. Corp., 32 N.C. App. 1, 231 S.E.2d 269, cert. denied, 292 N.C. 466, 233 S.E.2d 921 (1977).

Applied in Trio Estates, Ltd. v. Dyson, 10 N.C. App. 375, 178 S.E.2d 778 (1971); Hobson Constr. Co. v. Hajoca Corp., 28 N.C. App. 684, 222 S.E.2d 709 (1976); Angola Farm Supply & Equip. Co. v. FMC Corp., 59 N.C. App. 272, 296 S.E.2d 503 (1982).

Cited in Styron v. Loman-Garrett Supply Co., 6 N.C. App. 675, 171 S.E.2d 41 (1969); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980); Preston v. Thompson, 53 N.C. App. 290, 280 S.E.2d 780 (1981); Arrington v. Brad Ragan, Inc., 56 N.C. App. 416, 289 S.E.2d 122 (1982); Warren v. Joseph Harris Co., 67 N.C. App. 686, 313 S.E.2d 901 (1984); Ramsey Prods. Corp. v. Morbark Indus., Inc., 823 F.2d 798 (4th Cir. 1987); Ferguson v. Williams, 92 N.C. App. 336, 374 S.E.2d 438 (1988); Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 415 S.E.2d 574 (1992); Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993); McCorkle v. Aeroglide Corp., 115 N.C. App. 651, 446 S.E.2d 145 (1994); Dewitt v. Eveready Battery Co., 144 N.C. App. 143, 550 S.E.2d 511, 2001 N.C. App. LEXIS 432 (2001), cert. denied, 354 N.C. 216, 553 S.E.2d 398 (2001), aff'd, 355 N.C. 672, 565 S.E.2d 140 (2002).

§ 25-2-316. Exclusion or modification of warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (G.S. 25-2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this article on liquidation or limitation of damages and on contractual modification of remedy (G.S. 25-2-718 and 25-2-719). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence

and against unauthorized representations by the customary "lack of authority" clauses. This Article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this Article on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had "reason to know" under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in paragraphs (a), (b) and (c) of subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

7. Paragraph (a) of subsection (3) deals with general terms such as "as is," "as they stand," "with all faults," and the like. Such terms in ordinary commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms covered by paragraph (a) are in fact merely a particularization of paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under paragraph (b) of subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than proximately from a breach of warranty. See Sections 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient that the goods are available for inspection. There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however rejected by this Article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under paragraph (c) of that section in case of such an

inconsistency the implied warranty of merchantability is displaced by the express warranty that the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

Cross References:
Point 2: Sections 2-202, 2-718 and 2-719.
Point 7: Sections 1-205 and 2-208.

Definitional Cross References:
"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Course of dealing". Section 1-205.
"Goods". Section 2-105.
"Remedy". Section 1-201.
"Seller". Section 2-103.
"Usage of trade". Section 1-205.

NORTH CAROLINA COMMENT

Subsection (1) seems to accord with Case Threshing Mach. Co. v. McClamrock, 152 N.C. 405, 67 S.E. 991 (1910), that personal property may be sold with or without warranty if there is an express stipulation that the property is not warranted. See also Swift & Co. v. Etheridge, 190 N.C. 162, 129 S.E. 453 (1925). The intent to warrant is a matter which must appear in the form of the expression, aided in proper cases by the circumstances surrounding the transaction. Walston v. R. B. Whitley & Co., 226 N.C. 537, 39 S.E.2d 375 (1946). The whole contract should be examined.

Subsection (2) treats a subject that was cloaked in uncertainty in North Carolina. Could implied warranties be disclaimed by the seller? If so, what terms of disclaimer were required?

In Swift & Co. v. Etheridge, 190 N.C. 162, 129 S.E. 453 (1925), the seller sold goods and the instrument evidencing the sale said "without warranty as to results of its use, or otherwise." It was contended that this disclaimer negated all implied as well as express warranties. The court held the implied warranty "that the goods sold and delivered were merchantable, or salable, and fit for the purpose for which they were bought" was not effectively disclaimed or negated. See Hall Furniture Co. v. Crane Mfg. Co., 169 N.C. 41, 85 S.E. 35 (1915).

Yet, in Primrose Petroleum Co. v. Allen, 219 N.C. 461, 14 S.E.2d 402 (1941), where a special express warranty limited the liability of the seller to those express warranties stated in the special warranty, the court held that all other warranties ordinarily implied in sales contracts were excluded.

The UCC, by this section, attempts to spell out and to render certain a determination of when implied warranties have been effectively disclaimed. After having defined the implied warranty of merchantability, it states that to exclude this warranty, the disclaimer must mention merchantability and must be conspicuous. To disclaim the implied warranty of fitness, the exclusion must be by a writing and conspicuous.

Subsection (3)(a) allows all implied warranties to be excluded by "as is" or "with all faults" provisions that are clear to the buyer. This subsection accords with general commercial understanding.

Subsection (3)(b) accords with Driver v. Snow, 245 N.C. 223, 95 S.E.2d 519 (1956); Southern Box & Lumber Co. v. Home Chair Co., 250 N.C. 71, 108 S.E.2d 70 (1959): "There is no implied warranty where the buyer has knowledge equal to that of the seller . . . the presence of the goods at the time of the sale open and available for inspection . . . prevents the implication of warranties."

Subsection (3)(c) applies to nonmerchants and evinces what is left of the doctrine of caveat emptor.

Subsection (3)(c) has no apparent parallel in prior North Carolina law.

Subsection (4): See North Carolina Comments in connection with GS 25-2-718 and 25-2-719 for a discussion of the principles that govern subsection (4) of this section. See especially Allen v. Tompkins, 136 N.C. 208, 48 S.E. 655 (1904), that warranty provisions to a contract can limit liability to the making of repairs or the replacement of other goods in lieu of damages. See also Charles Hackley Piano Co. v. Kennedy, 152 N.C. 196, 67 S.E. 488 (1910).

Legal Periodicals. — For note on strict liability for breach of warranty, see 50 N.C.L. Rev. 697 (1972).

For survey of 1972 case law on recovery for personal injury under implied warranty, see 51 N.C.L. Rev. 1159 (1973).

For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For survey of 1976 case law on commercial law, see 55 N.C.L. Rev. 943 (1977).

For article, "North Carolina's New Products Liability Act: A Critical Analysis," see 16 Wake Forest L. Rev. 171 (1980).

For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For survey of 1980 commercial law, see 59 N.C.L. Rev. 1084 (1981).

For comment, "The Crashworthy Vehicle: Heading for a Collision in the North Carolina Courts," see 18 Wake Forest L. Rev. 711 (1982).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

For casenote: "Brevorka v. Wolfe Construction, Inc.: Did I Just Waive My Rights to the Implied Warranty of Workmanlike Construction?," see 26 N.C. Cent. L.J. 59 (2003).

CASE NOTES

This section is not in conflict with the provisions of the North Carolina Seed Law relating to labeled seed. Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976).

To be valid under this section, a disclaimer provision must be stated in express terms, mention "merchantability" in order to disclaim the implied warranty of merchantability, and be conspicuously displayed. Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

Buyer's Inspection Is Not Limited to Goods on Seller's Premises. — The principle in subsection (3)(b) of this section is not applicable where the contract of sale imposed on the seller the obligation to deliver a mobile home and block it on buyer's lot. Until that was properly done, fitness or unfitness for use as a home could not be ascertained by the buyer's examination and inspection of the goods on the seller's premises. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Provision Meeting Requirements of Subsection (2). — A provision which disclaims all other warranties, express and implied meets the requirements of subsection (2) where it was in writing, the implied warranty of merchantability was mentioned, and the exclusion was conspicuous as defined in § 25-1-201(10). Bulliner v. GMC, 54 F.R.D. 479 (E.D.N.C. 1971).

Fact that exclusion of warranty raised by parties' course of performance is oral does not vitiate its utility or relevance. Robinson v. Branch Moving & Storage Co., 28 N.C. App. 244, 221 S.E.2d 81 (1976).

Disclaimer and Substitution of § 25-2-719(1)(a) Limitations. — A merchant seller may disclaim all liability under subsection (2) stemming from any breach of warranties of merchantability and fitness under G.S. 25-2-314 and 25-2-315, substituting in place thereof the limitations of G.S. 25-2-719(1)(a). Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

This Section and § 25-2-719 Distinguished. — Although this section and G.S. 25-2-719 are closely related, the former is directed to the creation of a limited duty under the warranty, whereas the latter is directed to the limitation of the remedy available in the event of a breach of that duty. Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

Rejection of Express Warranty Did Not Act as Waiver. — Manufacturer's offer and owner's rejection of a five-year express warranty of the roof installed for owner did not fall within the exclusion provisions of this section; therefore, the offer and rejection of the express warranty did not automatically waive the implied warranty of merchantability. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989).

Clause Generally Disclaiming All Warranties Cannot Reduce Seller's Obligation. — Basic obligation created by description of goods cannot be retracted. A clause generally disclaiming all warranties, express or implied, cannot reduce seller's obligation with respect to such description. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Covenants to Repair and Replace Defective Parts. — Although limited warranties are valid, compliance with their covenants to repair and to replace defective parts requires that the warrantor do more than make good faith attempts to repair defects when requested to do so, and a manufacturer or other warrantor may be liable for breach of warranty when it repeatedly fails within a reasonable time to correct a defect as promised; moreover, a party seeking to recover for breach of a limited warranty is not required to give the warrantor unlimited opportunities to attempt to bring the item into compliance with the warranty. Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980).

A defendant is entitled to have his counterclaim, based upon a breach of implied warranty of merchantability, submitted to a jury unless the contract contains an exclusion or modification of the implied warranty. Trio Estates, Ltd. v. Dyson, 10 N.C. App. 375, 178 S.E.2d 778 (1971).

Defendant's subsequent verbal warranties may modify prior written contract and written disclaimer. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Seller's post-sale agreement with buyer to do major engine repairs without charge constituted an oral modification of original written agreement that there were no warranties, and was not subject to the parol evidence rule. Further, under G.S. 25-2-209(1), this agreement needed no consideration to be binding. Bone Int'l, Inc. v. Johnson, 74 N.C. App. 703, 329 S.E.2d 714 (1985).

Material Question of Fact Whether Quotation and Service Agreement Were One or Two Contracts. — Quotation and service agreement were on separate pieces of paper; each document contained a separate executory section, and each document could be read as an entire agreement in itself. There was no language of disclaimer in quotation; the only disclaimer appeared on service agreement. Thus there was a material question of fact as to whether the quotation and the service contract constituted either one contract for sale of goods or two contracts, one for sale of goods and one for sale of services. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Language Held Effective Disclaimer. — Language on herbicide to the effect that seller made "no other express or implied warranty of fitness or merchantability or any other express or implied warranty," which was in darker and larger type than the other language on the label, was "conspicuous," as defined by G.S. 25-1-201(10), and served to effectively disclaim any implied warranties of merchantability or fitness. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

Applied in Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975); General Elec. Co. v. Pennell, 31 N.C. App. 510, 229 S.E.2d 713 (1976); Bentley Mach., Inc. v. Pons Hosiery, Inc., 33 N.C. App. 482, 235 S.E.2d 790 (1977); Sealey v. Ford Motor Co., 499 F. Supp. 475 (E.D.N.C. 1980); Strong v. Johnson, 53 N.C. App. 54, 280 S.E.2d 37 (1981); Angola Farm Supply & Equip. Co. v. FMC Corp., 59 N.C. App. 272, 296 S.E.2d 503 (1982); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Wright v. T & B Auto Sales, Inc., 72 N.C. App. 449, 325 S.E.2d 493 (1985); Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988); Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992).

Cited in Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972); Griffin v. Wheeler-Leonard & Co., 290 N.C. 185, 225 S.E.2d 557 (1976); Coffer v. Standard Brands, Inc., 30 N.C. App. 134, 226 S.E.2d 534 (1976); Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976); Isaacson v. Toyota Motor Sales, U.S.A., Inc., 438 F. Supp. 1 (E.D.N.C. 1976); Batiste v. American Home Prods. Corp., 32 N.C. App. 1, 231 S.E.2d 269 (1977); Stone v. Paradise Park Homes, Inc., 37 N.C. App. 97, 245 S.E.2d 801 (1978); Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Simmons v. C.W. Myers Trading Post, Inc., 68 N.C. App. 511, 315 S.E.2d 75 (1984); Ramsey Prods. Corp. v. Morbark Indus., Inc., 823 F.2d 798 (4th Cir. 1987); Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990); Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992); Torrance v. AS & L Motors, Ltd., 119 N.C. App. 552, 459 S.E.2d 67 (1995); DeWitt v. Eveready Battery Co., 355 N.C. 672, 565 S.E.2d 140, 2002 N.C. LEXIS 548 (2002); RD&J Props. v. Lauralea-Dilton Enters., LLC, 165 N.C. App. 737, 600 S.E.2d 492, 2004 N.C. App. LEXIS 1517 (2004).

§ 25-2-317. Cumulation and conflict of warranties express or implied.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general langauge of description.
(b) A sample from an existing bulk displaces inconsistent general language of description.
(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
On cumulation of warranties see Sections 14, 15, and 16, Uniform Sales Act.

Changes: Completely rewritten into one section.

Purposes of Changes:

1. The present section rests on the basic policy of this Article that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This Article thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the circumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

Cross Reference:
Point 1: Section 2-315.

Definitional Cross Reference:
"Party". Section 1-201.

NORTH CAROLINA COMMENT

The first sentence of this section establishes the rule of construction that warranties, both express and implied, shall be construed as consistent unless such construction is unreasonable or contrary to the intention of the parties.

The first sentence also makes all warranties cumulative if consistent. This seems to conflict with Charles Hackley Piano Co. v. Kennedy, 152 N.C. 196, 67 S.E. 488 (1910); Farquhar Co. v. Hardy Hardware Co., 174 N.C. 369, 93 S.E. 922 (1917); Case Threshing Mach. Co. v. McClamrock, 152 N.C. 405, 67 S.E. 991 (1910); Armour Fertilizer Works v. Aiken, 175 N.C. 398, 95 S.E. 657 (1918), that an express warranty excludes an implied warranty as to closely related subjects or qualities in a thing sold. In other words, in North Carolina if there was an express warranty in connection with a matter, there was no implied warranty in connection with that matter which could coexist. Warranties were not cumulative, at least in all cases, in North Carolina. But see Hyman v. Broughton, 197 N.C. 1, 147 S.E. 434 (1929), that they were cumulative if they related to different matters.

Paragraph (a) is consistent with Pickrell & Craig Co. v. Wilson Wholesale Co., 169 N.C. 381, 86 S.E. 187 (1915), that every sale where a sample is shown is not a sale by sample where there are other exact or technical descriptive specifications. The intention of the parties governs.

There is no exact parallel to paragraph (b) but that subsection merely says that a specific description by sample will displace a description by general language.

Paragraph (c) changes prior North Carolina law. There was no implied warranty of fitness of purpose if there was an express warranty of quality. Hyman v. Broughton, 197 N.C. 1, 147 S.E. 434 (1929).

CASE NOTES

Express Warranty by Manufacturer Does Not Exclude Implied Warranty by Retailer. — This section provides that warranties, express and implied, should be construed as consistent with each other and as cumulative. Thus, if the manufacturer of a mobile home had given an express warranty, it would not necessarily exclude an implied warranty given by the retailer. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

§ 25-2-318. Third party beneficiaries of warranties express or implied.

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by Section 2-316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in Sections 2-718 or 2-719. To the extent that the contract of sale contains provisions under which warranties are excluded or modified, or remedies for breach are limited such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him.

3. This section expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

Cross References:

Point 1: Sections 2-316, 2-718 and 2-719.
Point 2: Section 2-314.

Definitional Cross References:

"Buyer". Section 2-103.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

North Carolina, in the absence of a warranty expressly directed to an ultimate consumer, required privity of contract between the parties to a warranty action before recovery was allowed. Wyatt v. North Carolina Equip. Co., 253 N.C. 355, 117 S.E.2d 21 (1960); Prince v. Smith, 254 N.C. 768, 119 S.E.2d 923 (1961). A warranting seller was liable only to the immediate buyer with whom there is a contractual relation. An employee of the buyer could not sue on the seller's warranty as the employee was a stranger to the contract. A purchaser from a retailer could not sue a manufacturer of defective goods with whom he has no contractual relation for breach of warranty. See Thomason v. Ballard & Ballard Co., 208 N.C. 1, 179 S.E. 30 (1935).

In such cases, the purchaser had to sue his immediate seller and in turn his immediate seller might sue his supplier and his supplier might ultimately reach the manufacturer. Prince v. Smith, 254 N.C. 768, 119 S.E.2d 923 (1961). But there could be no direct suit by an ultimate purchaser or consumer against a manufacturer or remote seller unless he had made an express warranty intended to attach to an item sold and intended to run to the ultimate consumer. See Simpson v. American Oil Co., 217 N.C. 542, 8 S.E.2d 813 (1940), to the effect that a warranty can be so stated that it will run from a manufacturer to an ultimate consumer.

Therefore, in North Carolina, if a mother purchased a product for consumption by her children or by a guest, if the product injured or poisoned her child or guest, the mother-purchaser only had an action for *her* damages due to breach of the retailer's warranty. *No one* had an action for breach of warranty against any wholesaler, jobber or manufacturer of the product as there was not the requisite privity.

Nor was the theory that a negligence action was permitted an adequate solution, especially in North Carolina, where the doctrine of res ipsa loquitur is not applicable to any appreciable degree. See Enloe v. Charlotte Coca-Cola Bottling Co., 208 N.C. 305, 180 S.E. 582 (1935), and cases there cited. Evidence of negligence other than mere injury from a product must be established.

The damages for the child's own injury or the damages for the guest's own injury would likely not be recovered by any method in North Carolina. Recovery on warranty was not allowed because of lack of privity; recovery on negligence would not likely be available, either from lack of any negligence, or because of difficulty of proof, especially in light of North Carolina's law on res ipsa loquitur.

The UCC provision allows the seller's warranty, express or implied, to run to persons other than the immediate buyer who are in the family or household of the buyer or who is a guest of the buyer, if it is reasonable that these persons should use or consume or be affected by the goods.

The UCC does away with the doctrine of privity in extending coverage of warranty to a buyer's family, household and guests. The UCC does *not* abolish North Carolina's requirement of privity with reference to strangers to the contract such as employees. See Wyatt v. North Carolina Equip. Co., 253 N.C. 355, 117 S.E.2d 21 (1960). Nor does it affect the requirement of privity that prevents a cause of action by any ultimate consumer or buyer against a remote seller or manufacturer. See Thomason v. Ballard & Ballard Co., 208 N.C. 1, 179 S.E. 30 (1935); Perfecting Serv. Co. v. Product Dev. & Sales Co., 261 N.C. 660, 136 S.E.2d 56 (1964); Murray v. Benson Aircraft Corp., 259 N.C. 638, 131 S.E.2d 367 (1963); Prince v. Smith, 254 N.C. 768, 119 S.E.2d 923 (1961).

Legal Periodicals. — For comment on implied warranty of fitness, see 4 Wake Forest Intra. L. Rev. 169 (1968).

For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For survey of 1972 case law on recovery for personal injury under implied warranty, see 51 N.C.L. Rev. 1159 (1973).

For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For article, "North Carolina's New Products Liability Act: A Critical Analysis," see 16 Wake Forest L. Rev. 171 (1980).

For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For article, "Products Liability — Emerging Consensus and Persisting Problems: An Analytical Review Presenting Some Options," 25 Campbell L. Rev. 1 (2002).

CASE NOTES

General Rule Is That Only Person in Privity May Recover. — Subject to some exceptions, it is the general rule that only a person in privity with the warrantor may recover on the warranty. Williams v. GMC, 19 N.C. App. 337, 198 S.E.2d 766, cert. denied, 284 N.C. 258, 200 S.E.2d 659 (1973).

Church Member Not in Privity of Contract. — Church member, who was trapped inside the church's walk-in freezer and suffered severe frostbite, could not be considered as a member of the church's "family" or "household" or a guest in the church's "home," for the purpose of maintaining a products liability action based on a breach of seller's express and implied warranties without establishing privity of contract. Crews v. W.A. Brown & Son, 106 N.C. App. 324, 416 S.E.2d 924 (1992).

Privity Requirement Relaxed as to Sale of Goods. — As a general rule, one seeking to recover on an implied warranty is still required to prove privity of contract. This privity requirement has been relaxed in cases involving the sale of goods by this section. However, this relaxation of the privity requirement has not yet been extended to services. Jones v. Clark, 36 N.C. App. 327, 244 S.E.2d 183 (1978).

But Plaintiff Must Be Person to Whom Section Extends Warranties. — There can be no recovery by implied warranty where the plaintiff is not one of those persons to whom the implied warranties extend by this section. Williams v. GMC, 19 N.C. App. 337, 198 S.E.2d 766, cert. denied, 284 N.C. 258, 200 S.E.2d 659 (1973).

Plaintiff could not take advantage of any warranties implied by the Uniform Commercial Code where her evidence showed that she was not a member of the family or household or a guest in the home of the buyer so as to escape the privity requirement. Williams v. GMC, 19 N.C. App. 337, 198 S.E.2d 766, cert. denied, 284 N.C. 258, 200 S.E.2d 659 (1973).

Privity Requirement Governed by Case Law. — Whether there exists a requirement of privity or contractual relationship is not governed by the UCC, but by developing case law. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

This section eliminates the need for privity when a natural person is suing to recover for personal injuries, but is silent as to whether privity is required in other contexts. Courts will turn to case law to determine whether privity is required between buyers and sellers. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

When Absence of Privity Not Fatal. — Where a plaintiff alleges an express warranty running directly to him, breach of that warranty, and damages caused by the breach, the absence of an allegation of privity between plaintiff and the warrantor in the sale of the warranted item is not fatal to the claim. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

Element of reliance can often be inferred from allegations of mere purchase or use if the natural tendency of the representations made is such as to induce such purchase or use. Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

An individual partner may sue to recover damages for his personal injuries which proximately result from the breach of warranty on goods purchased by the partnership with partnership funds. Barnes v. Campbell Chain Co., 47 N.C. App. 488, 267 S.E.2d 388 (1980).

A partner is not an employee of the partnership entity; rather, the partner is a tenant in partnership in the entity itself, and as such, the partner is a purchaser of goods purchased with partnership funds by the partnership, not an employee of the purchaser and the partner has direct contractual privity. Barnes v. Campbell Chain Co., 47 N.C. App. 488, 267 S.E.2d 388 (1980).

Applied in Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344 (1979); Davis v. Siloo Inc., 47 N.C. App. 237, 267 S.E.2d 354 (1980).

Cited in Boudreau v. Baughman, 86 N.C. App. 165, 356 S.E.2d 907 (1987); Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993).

§ 25-2-319. F.O.B. and F.A.S. terms.

(1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this article (G.S. 25-2-504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this article (G.S. 25-2-503);

(c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this article on the form of bill of lading (G.S. 25-2-323).

(2) Unless otherwise agreed the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must

(a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsection (1)(a) or (c) or subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this article (G.S. 25-2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which have led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt with in this Act by Section 2-311(2) (seller's option re arrangements relating to shipment) and Sections 2-614 and 615 (substituted performance and seller's excuse).

2. Subsection (1)(c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in subsection (1)(c) and subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring into play, instead, the second sentence of Section 2-704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and case law; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., Section 2-320).

Cross References:
Sections 2-311(3), 2-323, 2-503 and 2-504.

Definitional Cross References:
"Agreed". Section 1-201.
"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Goods". Section 2-105.
"Seasonably". Section 1-204.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsections (1)(a) and (b) are in accord with prior North Carolina law as to F.O.B. shipments. See Peed v. Burleson's, Inc., 244 N.C. 437, 94 S.E.2d 351 (1956): "Where the contract of sale provides for a sale F.O.B. the point of shipment, the title is generally held to pass, in the absence of a contrary intention between the parties, at the time of the delivery of the goods for shipment at the point designated . . .. If the seller by his contract undertakes to make the delivery himself at the point of destination, thus assuming the risk in the carriage, the delivery to a carrier is not a delivery to the buyer." See also Acme Paper Box Factory v. Atlantic Coast Line R.R., 148 N.C. 421, 62 S.E. 557 (1908). That this rule could be changed according to the intention of the parties, see Gulf Ref. Co. v. Charlotte Constr. Co., 157 N.C.

277, 72 S.E. 1003 (1911).

The remainder of GS 25-2-319 is new in North Carolina, and the detailed obligations set out under F.O.B. and F.A.S. contracts fill gaps not treated in decisional law.

§ 25-2-320. C.I.F. and C. & F. terms.

(1) The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C. & F. or C.F. means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to

(a) put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract; and

(e) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term C. & F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(4) Under the term C.I.F. or C. & F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination".

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance — for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be

read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not required to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner. Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of playing or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation in the appropriate space on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, sufficiently shown to cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other considerations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this Article.

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods against at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship "freight collect" and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the buyer's risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier "ship and/or cargo lost or not lost," or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance "for the account of whom it may concern" is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be "sufficiently shown to cover the same goods covered by the bill of lading." It must cover separately the quantity of goods called for by the buyer's contract and

not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term "certificate of insurance", however, does not of itself include certificates or "cover notes" issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers' certificates and "cover notes" but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller's failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e. g., one insuring the goods "lost or not lost." The provisions of this Article on cure of improper tender and on waiver of buyer's objections by silence are applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document which evidences points of description, quality and the like which do not readily appear in other documents. This Article rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time".

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the nonconformity of the goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point to a seaport and thence transported by vessel to the named destination under a "through" or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller's control.

14. Although subsection (2) stating the legal effects of the C.I.F. term is an "unless otherwise agreed" provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed from designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F.

term by purchasing and tendering landed goods.

16. Under the C. & F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C. & F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer's agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an "open" or "floating" policy covering all shipments made by him or to him, in either of which events the C. & F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

Cross References:

Point 4: Section 2-323.
Point 6: Section 2-509(1) (a).
Point 9: Sections 2-508 and 2-605(1) (a).
Point 12: Sections 2-321(3), 2-512 and 2-513(3) and Article 5.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Rights". Section 1-201.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

No North Carolina cases or statutes were found dealing with C.I.F. or C. & F. terms in sales contracts. This provision codifies for the most part case law developed over the country concerning the C.I.F. contract. See Official Comment. See Vold, Sales 199 et seq. (2d ed.).

This is entirely new material.

§ 25-2-321. C.I.F. or C. & F.: "Net landed weights"; "payment on arrival"; warranty of condition on arrival.

Under a contract containing a term C.I.F. or C. & F.

(1) Where the price is based on or is to be adjusted according to "net landed weights," "delivered weights," "out turn" quantity or quality or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.

(2) An agreement described in subsection (1) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost delivery of the documents and payment are due when the goods should have arrived. (1965 c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C. & F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

Cross Reference:
Section 2-324.

Definitional Cross References:
"Agreement". Section 1-201.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Goods". Section 2-105.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

As previously stated, there were no C.I.F. or C. & F. cases or statutes in North Carolina.

This is entirely new material.

§ 25-2-322. Delivery "ex-ship."

(1) Unless otherwise agreed a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed

(a) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and

(b) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:

1. The delivery term, "ex ship" as between seller and buyer, is the reverse of the f.a.s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex ship", even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropriate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex ship" with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

Cross Reference:
Point 1: Section 2-319(2).

Definitional Cross References:
"Buyer". Section 2-103.
"Goods". Section 2-105.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

There were no cases or statutes dealing with "ex-ship" provisions found in North Carolina. This provision is somewhat the overseas shipment parallel to the "F.O.B. destination" contract on an overland shipment wherein the risk remains with the seller until they reach their destination. Compare Peed v. Burleson's, Inc., 244 N.C. 437, 94 S.E.2d 351 (1956). See GS 25-2-319. The difference, however, is that this provision shifts the risk and expenses to the buyer at the unloading from the vessel, while in the F.O.B. contract the risk normally passes upon tender of the goods at the destination even though they may still be in the possession of the carrier.

This section is entirely new and has no statutory or decisional parallel in prior North Carolina law.

§ 25-2-323. Form of bill of lading required in overseas shipment; "overseas."

(1) Where the contract contemplates overseas shipment and contains a term C.I.F. or C. & F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C. & F., received for shipment.

(2) Where in a case within subsection (1) of this section a tangible bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set

(a) due tender of a single part is acceptable within the provisions of this Article on cure of improper delivery (subsection (1) of G.S.25-2-508); and

(b) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air or a contract contemplating such shipment is "overseas" insofar as by usage of trade or agreement it is subject to the commercial, financing or shipping practices characteristic of international deep water commerce. (1965, c. 700, s. 1; 2006-112, s. 30.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See Section 2-319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming.

This subsection codifies that practice as between buyer and seller. Article 5 (Section 5-113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article 5.

Cross References:

Sections 2-508(2), 5-113.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Financing agency". Section 2-104.
"Person". Section 1-201.
"Seller". Section 2-103.
"Send". Section 1-201.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

There is neither decisional nor case law bearing upon the subject matter of this section. This section is entirely new in North Carolina law.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 30, effective October 1, 2006, substituted "subsection (1) of this section a tangible bill of lading" for "subsection (1) a bill of lading" in the introductory paragraph of subsection (2); and made a minor stylistic change in subdivision (2)(a).

§ 25-2-324. "No arrival, no sale" term.

Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed,

(a) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the non-arrival; and

(b) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (G.S. 25-2-613). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller out gives him an exemption from liability for non-delivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances impose upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming one, for the exemption under a "no arrival, no sale" term applies only to the hazards of transportation and the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the "no arrival, no sale" clause to exemption from payment of damages for non-delivery if the goods do not arrive or if the goods which actually arrive are non-conforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this Article on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the

contract refers there can be no application of an exemption for their non-arrival.

3. The seller's duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase "to arrive" is often employed in the same sense as "no arrival, no sale" and may then be given the same effect. But a "to arrive" term, added to a C.I.F. or C. & F. contract, does not have the full meaning given by this section to "no arrival, no sale". Such a "to arrive" term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the "to arrive" term may be regarded as a time of payment term, or, in the case of the reselling seller discussed in point 1 above, as negating responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of Sections 2-316 and 2-317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this Article on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

Cross References:

Point 1: Section 1-203.
Point 2: Section 2-501(a) and (c).
Point 5: Section 2-613.

Definitional Cross References:

"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Fault". Section 1-201.
"Goods". Section 2-105.
"Sale". Section 2-106.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

There is no North Carolina authority on the subject matter of this section. It allocates risks in regard to shipments where seller bears risk of loss during shipment, but negates any liability to buyer where shipment does not arrive and seller is not responsible for its failure to arrive.

This is entirely new to North Carolina law.

§ 25-2-325. "Letter of credit" term; "confirmed credit."

(1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit":

1. Subsection (2) follows the general policy of this Article and Article 3 (Section 3-802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (3) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary,

unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under Section 5-116(2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require the obligation of two banks both local to the seller.

Cross References:

Sections 2-403, 2-511(3) and 3-802 and Article 5.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Draft". Section 3-104.
"Financing agency". Section 2-104.
"Notifies". Section 1-201.
"Overseas". Section 2-323.
"Purchaser". Section 1-201.
"Seasonably". Section 1-204.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

North Carolina has no prior statutory or decisional law on the matters covered by this section. This section, as other sections starting with GS 25-2-319, continues to define and fix the meanings of numerous commercial terms and abbreviations.

This section is new to North Carolina law.

§ 25-2-326. Sale on approval and sale or return; rights of creditors.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is:

(a) a "sale on approval" if the goods are delivered primarily for use, and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this article (G.S. 25-2-201) and as contradicting the sale aspect of the contract within the provisions of this article on parol or extrinsic evidence (G.S. 25-2-202). (1965, c. 700, s. 1; 2000-169, s. 10.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Prior Uniform Statutory Provision: Section 19(3), Uniform Sales Act.

Changes: Completely rewritten in this and the succeeding section.

Purposes of Changes: To make it clear that:

1. Both a "sale on approval" and a "sale or return" should be distinguished from other types of transactions with which they frequently have been confused. A "sale on approval," sometimes also called a sale "on trial" or "on satisfaction," deals with a contract under which the seller undertakes a risk in order to satisfy its prospective buyer with the appearance or performance of the goods that are sold. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. A "sale or return," on the other hand, typically is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. A sale or return is a present sale of goods which may be undone at the buyer's option. Accordingly, subsection (2) provides that goods delivered on approval are not subject to the prospective buyer's creditors until acceptance, and goods delivered in a sale or return are subject to the buyer's creditors while in the buyer's possession.

These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

2. The right to return goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this section or Section 2-327. This section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted. This section nevertheless pre-supposes that a contract for sale is contemplated by the parties although that contract may be of the particular character that this section addresses (i.e., a sale on approval or a sale or return).

If a buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" when an industrial machine is involved, this Article takes no position.

3. Subsection (3) resolves a conflict in the pre-UCC case law by recognizing that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that if a written agreement is involved the "or return" term must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parole or extrinsic evidence are concerned.

4. Certain true consignment transactions were dealt with in former Sections 2-326(3) and 9-114. These provisions have been deleted and have been replaced by new provisions in Article 9. See, e.g., Sections 9-109(a)(4); 9-103(d); 9-319.

Cross References:

Point 2: Article 9.
Point 3: Sections 2-201 and 2-202.

Definitional Cross References:

"Between merchants". Section 2-104.
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract for sale". Section 2-106.
"Creditor". Section 1-201.
"Goods". Section 2-105.
"Sale". Section 2-106.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsections (1)(a) and (2) define and state the effect of a "sale on approval." There is no real change in prior North Carolina law. See United States v. One 1955 Model Ford, 157 F. Supp. 798 (E.D.N.C. 1957); Glascock v. Hazell, 109 N.C. 145, 13 S.E. 789 (1891), that in a sale on approval where goods are subject to approval by the vendee, title does not vest in the vendee until such approval is manifested. This, of course, would determine the rights of creditors, risk of loss, etc., in North Carolina.

There are apparently no "sale or return" cases in North Carolina which treat the exact subject matter of these subsections, but subsections (1)(b) and (2) relating to "sale or return" contracts are in accord with the general understanding of the consequences of this type contract. (Title passes immediately upon delivery to the buyer subject to the buyer's right, a condition subsequent, to return the item to the seller and to revest the title in the seller. The ordinary incidents of ownership are in the buyer until the buyer's option to return is exercised. This would include the risk of loss, rights of creditors, etc.) See Vold, Sales 382-3 (2d ed.). Compare Fountain v. Jones, 181 N.C. 27, 106 S.E. 26 (1921). These subsections more clearly define the terms "sale on approval" and "sale or return" and their consequences in North Carolina but there is no real change in prior law.

Subsection (3) provides that where a person has a place of business at which he deals in goods of the kind received for sale under a name other than that of the person making delivery, words such as "on consignment" purporting to reserve title until payment will not prevent a transaction from being a sale or return, thus subjecting the goods to levy by the creditors of the person receiving delivery. Thus, possible doubts as to the nature of the transaction are resolved in favor of creditors of the person receiving delivery. The possibility of using a form of bailment to conceal what is essentially a sale is reduced. Provisions are made whereby the seller-consignor can protect himself by following specified procedures.

Subsection (3) is entirely new in North Carolina law.

Subsection (4) states, in effect, that any "or return" provision is so definitely at odds with any ordinary contract for the sale of goods that where written agreements are involved the "or return" provision must be contained in a written memorandum. It contradicts the "sale" aspect of the contract within the parol evidence rule. While North Carolina did not have the statute of frauds as to contracts for the sale of personal property, it did have the parol evidence rule. Subsection (4) accords with the case of Shoop Family Medicine Co. v. Davenport, 163 N.C. 294, 79 S.E. 602 (1913) and Shoop Medicine Co. v. J. A. Mizell & Co., 148 N.C. 384, 62 S.E. 511 (1908). Where there is a written contract of sale the buyer may not introduce parol agreement allowing return of the article purchased not contained in the written agreement. The UCC provision accords in result with prior North Carolina law.

Editor's Note. — The comments to this section contain technical amendments approved through July, 2000.

Legal Periodicals. — For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 522 (1977).

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

CASE NOTES

This section is to be liberally interpreted. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Purpose. — The purpose of this section is to protect innocent creditors from deception by ostensible ownership. Nasco Equip. Co. v. Mason, 291 N.C. 145, 229 S.E.2d 278 (1976); BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

This section is intended for the benefit of secured creditors of the consignee as well as unsecured creditors. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Subdivision (3)(a) was not designed to give public notice of which particular person or organization claimed ownership in the goods. Rather, it was designed to be consistent with subdivision (3)(b), which focuses upon the concept of general notice. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

The purpose of subdivision (3)(a) is to provide public notice that the person in possession of the goods is not the owner. It alerts creditors to the fact that certain property in the possession the debtor is encumbered. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

The hallmark of consignment is the absence of an absolute obligation on the part of the consignee to pay for the goods. American Clipper Corp. v. Howerton, 311 N.C. 151, 316 S.E.2d 186 (1984).

All consignment agreements are subject to the requirements of this section. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Transactions Formerly Considered Consignments May Now Be Treated as Sales. — Under the UCC, many transactions that might have been regarded as consignments creating a principal-agent relationship under pre-Code law will be regarded as sales, at least in instances where claims by creditors of the consignee are at issue, or as "sale or return" transactions. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

This statute does not contemplate that a consignor's interest in goods be known to the community of creditors, but only that the consignee is generally known by such creditors to be selling the goods of others. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

The special priority rule (§ 25-9-114) does not apply to true consignors engaged in deemed sales or returns that comply with Article 2 by satisfying the requirements of a non-Code sign statute or by bearing the heavy burden of showing that a consignor generally is known by creditors substantially to be engaged in selling the goods of others. The special priority rule applies only if a consignor either elects to comply with Article 2 by filing under Article 9 or is required to do so in order to preserve priority under Article 2. BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Parol evidence cannot be introduced to engraft an "or return" consignment provision onto a paper writing. Recreatives, Inc. v. Travel-On Motorcycles Co., 29 N.C. App. 727, 225 S.E.2d 637 (1976).

Applied in Equitable Factors Co. v. Chapman-Harkey Co., 43 N.C. App. 189, 258 S.E.2d 376 (1979).

§ 25-2-327. Special incidents of sale on approval and sale or return.

(1) Under a sale on approval unless otherwise agreed

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

(b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and

(c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed

(a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) the return is at the buyer's risk and expense. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 19(3), Uniform Sales Act.

Changes: Completely rewritten in preceding and this section.

Purposes of Changes: To make it clear that:

1. In the case of a sale on approval:

If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this Article allowing partial acceptance of a defective delivery has no application here. A case where a buyer takes home two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed".

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in Section 1-204. Nevertheless, the provisions of both this Article and of the contract on this point must be read with commercial reason and with full attention to good faith.

Cross References:

Point 1: Sections 2-501, 2-601 and 2-603.
Point 2: Sections 2-607 and 2-608.
Point 4: Sections 1-201 and 1-204.

Definitional Cross References:

"Agreed". Section 1-201.
"Buyer". Section 2-103.
"Commercial unit". Section 2-105.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Notifies". Section 1-201.
"Notification". Section 1-201.
"Sale on approval". Section 2-326.
"Sale or return". Section 2-326.
"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1)(a) accords with United States v. One 1955 Model Ford, 157 F. Supp. 798 (E.D.N.C. 1957) and Glascock v. Hazell, 109 N.C. 145, 13 S.E. 789 (1891).

Subsection (1)(b) would seem to accord with North Carolina cases that a right of inspection must be exercised within a reasonable time or the buyer will become owner and the right to reject is waived. Fountain v. Jones, 181 N.C. 27, 106 S.E. 26 (1921). A use of the item purchased, however, which is consistent with purpose of trial is not acceptance. See Parker v. Fenwick, 138 N.C. 209, 50 S.E. 627 (1905).

Subsection (1)(c) has no statutory or decisional parallel in prior North Carolina law but seems reasonable as to what the law would probably have been in North carolina as pieced together from previously cited cases wherein title determines such crucial matters as the risk of loss and creditors' rights.

Subsection (2)(a) is in substantial accord with prior North Carolina law. See Fountain v. Jones, 181 N.C. 27, 106 S.E. 26 (1921). The addition of the provision for return of "any commercial unit of goods" is new to North Carolina law.

Subsection (2)(b): There is no statutory or decisional parallel to subsection (2)(b) in prior North Carolina law, but since under such law title passed to a buyer on a "sale or return" contract, subject to being revested in the seller upon redelivery, it would appear that until such redelivery the expenses of redelivery and the risk of loss should be on the buyer. See again Fountain v. Jones, 181 N.C. 27, 106 S.E. 26 (1921).

§ 25-2-328. Sale by auction.

(1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 21, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: To make it clear that:

1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This Article accepts the view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present. This is subject to any peculiar facts which might bring the case within the "firm offer" principle of this Article, but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

Cross Reference:
Point 2: Section 2-205.

Definitional Cross References:
"Buyer". Section 2-103.

"Good faith". Section 1-201.
"Goods". Section 2-105.
"Lot". Section 2-105.
"Notice". Section 1-201.
"Sale". Section 2-106.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with the general understanding of the law of sales by auction. It is practically a verbatim copy of G.S. 21(1) of the Uniform Sales Act, which is generally thought of as a codification of the common law of sales in most particulars.

Subsection (2): The first sentence of subsection (2) follows the Uniform Sales Act, G.S. 21(2), which is the general law as to when title passes in auction sales. Compare Love v. Harris, 156 N.C. 88, 72 S.E. 828 (1911). There are apparently no cases in North Carolina relating to reopening bids when a bid is made while the hammer is falling. This is covered by the second sentence of subsection (2).

Subsection (3): While no cases have been found in connection with the reserve rights of a seller at an auction which are covered by subsection (3), this provision accords with the Restatement, Contracts, G.S. 27 (1932), that a sale by auction is with reserve unless otherwise indicated, entitling the seller to withdraw the goods at any time before the bid is accepted. It also accords with the Uniform Sales Act, G.S. 21 (2). It is believed that this also accords with prior North Carolina law.

Subsection (4) follows prior North Carolina law in permitting a buyer to avoid an auction sale at which the seller or his agent bid. See Morehead v. Hunt, 16 N.C. 35 (1826); Woods v. Hall, 16 N.C. 411 (1830); McDowell v. Simms, 41 N.C. 278 (1849). That by-bidding may be permissible if notice is given to the vendee, see McDowell v. Simms, 41 N.C. 278 (1849). This section of the UCC adds, however, a provision not in the prior North Carolina law that the buyer has the option of taking at the last bona fide bid made where by-bidding by the seller or his agent is present. Another innovation is that at forced sales unannounced bidding on behalf of the seller is permitted.

For the most part this section of the UCC restates and amplifies generally accepted rules relating to auction sales. There are few innovations.

PART 4.

Title, Creditors and Good Faith Purchasers.

§ 25-2-401. Passing of title; reservation for security; limited application of this section.

Each provision of this article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (G.S. 25-2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this chapter. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the article on secured transactions (article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a tangible document of title, title passes at the time when and the place where he delivers such documents and if the seller is to deliver an electronic document of title, title passes when the seller delivers the document; or

(b) if the goods are at the time of contracting already identified and no documents of title are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale." (1965, c. 700, s. 1; 2006-112, s. 31.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See generally, Sections 17, 18, 19 and 20, Uniform Sales Act.

Purposes: To make it clear that:

1. This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this Article that known purpose and reason should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this Article in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in Section 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this Article such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to goods on the seller's insolvency, and on the buyer's right to specific performance or replevin.

4. The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, i. e. the delivery of documents or the making of the contract.

Cross References:

Point 2: Sections 2-102, 2-501 and 2-502.

Point 3: Sections 1-201, 2-402, 2-403, 2-502 and 2-716.

Definitional Cross References:

"Agreement". Section 1-201.
"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 2-103.
"Goods". Section 2-105.
"Party". Section 1-201.
"Purchaser". Section 1-201.
"Receipt" of goods. Section 2-103.
"Remedy". Section 1-201.
"Rights". Section 1-201.
"Sale". Section 2-106.
"Security interest". Section 1-201.
"Seller". Section 2-103.
"Send". Section 1-201.

NORTH CAROLINA COMMENT

The UCC abandons "lump concept thinking," that made rights, obligations and remedies of sellers, buyers and third parties dependent on the location of the title of goods at a particular time. It substitutes therefor "narrow issue thinking" by providing specific provisions with respect to the various rights and duties of the buyer and seller which are not predicated on location of title.

For the most part, the same results will be obtained in North Carolina under the UCC as under prior law although the "search for title" theory of deciding many sales cases is abandoned.

Subsection (1): The first sentence of subsection (1) accords with Blakely v. Patrick, 67 N.C. 45 (1872); Waldo v. Belcher, 33 N.C. 609 (1850), that title cannot pass until goods are identified or appropriated to the contract.

The second sentence of subsection (1) is contrary to prior North Carolina law. See Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924), that where, by form of bill of lading, seller retains title to goods shipped for security purposes, other incidents such as risk of loss follows the title. See also Penniman v. Winder, 180 N.C. 73, 103 S.E. 908 (1920). The buyer and seller, of course, can provide by their contract when title to goods shall pass.

Subsection (2) accords with Richardson v. Insurance Co. of North America, 136 N.C. 314, 48 S.E. 733 (1904); Teague v. Howard Grocery Co., 175 N.C. 195, 95 S.E. 173 (1918); Jenkins v. Jarrett, 70 N.C. 255 (1874), except that if goods are shipped and seller retains shipping documents such as the bill of lading made out to "order of seller," the seller retains title and the risk of loss is on the seller. See Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924). See also Peed v. Burleson's, Inc., 244 N.C. 437, 94 S.E.2d 351 (1956), that title and risk of loss remain in the seller if by the contract the seller agrees to deliver to the buyer at the destination. This accords with subsection (2)(b).

Subsection (3) accords with prior North Carolina law. See above paragraph. Title passes upon making contract if goods are in a deliverable state.

Subsection (4) accords with prior North Carolina law that title revests in the seller upon a rescission by the buyer. See Hutchins v. Davis, 230 N.C. 67, 52 S.E.2d 210 (1949). The part of the subsection which places the title in the seller even if the buyer makes a *wrongful* repudiation of the contract is new.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 31, effective October 1, 2006, in subdivision (3)(a), inserted "tangible" preceding "document of title," near the beginning, and added "and if the seller is to deliver an electronic document of title, title passes when the seller delivers the document" at the end; and inserted "of title" following "documents" in subdivision (3)(b).

Legal Periodicals. — For 1984 survey, "The Application of the North Carolina Motor Vehicle Act and the Uniform Commercial Code to the Sale of Motor Vehicles by Consignment," see 63 N.C.L. Rev. 1105 (1985).

For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

CASE NOTES

Concept of Title Abandoned. — The most basic departure from previous law is found in the Uniform Commercial Code is the abandonment of the concept of title as a tool for resolving sales problems. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970); Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Completed Delivery Consummates Sale. — If there has been a completed delivery by the seller, the sale has been consummated and implied warranties arise under G.S. 25-2-314. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Time of Payment Does Not Determine Time of Sale. — Under subdivision (2) the time of payment is not determinative of the question of when a sale takes place. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Possession of Product in Self-Service Store Constitutes Sale. — The presence of soft drinks on the shelves of a self-service store constituted an offer for sale and delivery at a stated price; a sale occurred when the purchaser took the drinks into his possession with the intention of paying for them at the cashier's counter. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

And Seller Retains a Security Interest. — As long as a purchaser in a self-service store has a product in his possession, intending to pay for it, he has title to the product, and the seller's interest at that point is not "title" but a security interest to enforce payment; when the purchaser changes his mind and returns to the shelf a product which he has picked up with the intention of buying it, title is revested in the seller. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Effect of Right to Return. — Under subdivision (4) a right to return delivered goods to the seller does not necessarily delay passage of title until that right has expired. Gillispie v. Great Atl. & Pac. Tea Co., 14 N.C. App. 1, 187 S.E.2d 441 (1972).

Effect of Reservation of Title by Seller. — Where there has been delivery to the buyer, a reservation of title by the seller, by express provision of the Code, is limited in effect to a reservation of a security interest. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

Interpretation of UCC Where Public Regulation Involved. — The official comment to this section seems to say that the UCC makes no attempt to set out a specific line of interpretation where a public regulation is involved, but that in case a court should decide to apply this private law definition and reasoning to its public regulation, that there should be a clear and concise definitional basis for so doing. Such comment leads to the conclusion that the sales act, a private law, is not necessarily applicable to public regulations unless the court chooses to make it so. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

Transfer of Ownership of Motor Vehicle. — The provisions of § 20-72(b) contain specific, definite and comprehensive terms concerning the transfer of ownership of a motor vehicle. Conversely, the UCC does not refer to transfer of ownership of motor vehicles, but only refers to the passing of title to property generally described as "goods." Although the word "automobile" comes within the general term of "goods," automobiles are a special class of goods which have long been heavily regulated by public regulatory acts. Section 20-72(b) is a special statute and the UCC is a general statute. Thus, the special statute, even though earlier in point of time, must prevail. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

The documents of title referred to in this section do not include certificates of title to motor vehicles. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

The provisions of the UCC do not override the earlier motor vehicle statutes relating to the transfer of ownership of motor vehicles for the purpose of tort law and liability insurance coverage. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

Where the transaction at issue in the adversary proceeding involved the sale and financing of the motor vehicle at issue, the provisions of G.S. 25-2-401 controlled the transfer of title for the car, rather than the titling and registration provisions of the North Carolina Motor Vehicle Act. Ivey v. Wilson (In re Payne), — Bankr. —, 2006 Bankr. LEXIS 4199 (Bankr. M.D.N.C. Dec. 6, 2006).

Passing of Title Upon Delivery. — Seller's motion to amend a complaint to add a claim to recover possession of a new tractor that the seller sold to the buyer, based upon the seller's assertion that title to the tractor never passed from the seller to the buyer, was denied because the seller failed to state a claim as, pursuant to G.S. 25-2-401, the title to the tractor passed to the buyer when the seller delivered the tractor to the buyer. Riddle Farm Equip., Inc. v. Boles (In re Boles), — Bankr. —, 2004 Bankr. LEXIS 2384 (Bankr. M.D.N.C. Oct. 26, 2004).

Debtor was the owner of the automobile at issue and the creditor did not retain an ownership interest, only a security interest in the vehicle, when the debtor and the creditor entered into a promissory note and security agreement whereby the debtor agreed to purchase the automobile. Ivey v. Wilson (In re Payne), — Bankr. —, 2006 Bankr. LEXIS 4199 (Bankr. M.D.N.C. Dec. 6, 2006).

As to controlling effect of UCC with regard to security interests and priorities, see North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Section Controls as to Aircraft. — There is no statute applicable particularly to aircraft, but this section, which is applicable to sales of "goods" generally, is controlling. Norris v. Insurance Co. of N. Am., 26 N.C. App. 91, 215 S.E.2d

379, cert. denied, 288 N.C. 242, 217 S.E.2d 666 (1975).

Effect of Wrongful Transfer of Property by Bailee in Possession. — In the absence of grounds for an estoppel and except as provided in § 25-2-403(2) or this section, no right, title, or interest may be acquired as the result of an unauthorized or wrongful sale, gift, exchange, pledge, mortgage, or other transfer of property by a bailee in possession, even though to an innocent purchaser. The bailor is not divested of his title by such an unauthorized act and may recover the property or its value from the vendee or transferee in any appropriate form of action. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

Applied in Nasco Equip. Co. v. Mason, 291 N.C. 145, 229 S.E.2d 278 (1976); North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978); Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983); American Clipper Corp. v. Howerton, 311 N.C. 151, 316 S.E.2d 186 (1984).

Cited in Fisher v. Elmore, 610 F. Supp. 123 (E.D.N.C. 1985); North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985); Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986); In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-402. Rights of seller's creditors against sold goods.

(1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this article (G.S. 25-2-502 and 25-2-716).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the article on secured transactions (article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this article constitute the transaction a fraudulent transfer or voidable preference. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (2) — Section 26, Uniform Sales Act; Subsections (1) and (3) — none.

Changes: Rephrased.

Purposes of Changes and New Matter: To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hinderance by making it clear that:

1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this Article, but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this Article.

2. The retention of possession of the goods by a merchant seller for a commercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of subsection (3) have no application to identification or delivery made in the current course of trade, as measured against general commercial understanding of what a "current" transaction is.

Definitional Cross References:

"Contract for sale". Section 2-106.
"Creditor". Section 1-201.
"Good faith". Section 2-103.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Money". Section 1-201.
"Reasonable time". Section 1-204.
"Rights". Section 1-201.
"Sale". Section 2-106.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section, the intent of which is to preserve local law except where local law would make retention of possession of goods by a merchant-seller fraudulent as against creditors if such retention is in the ordinary course of business, does not affect North Carolina law.

Legal Periodicals. — For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

§ 25-2-403. Power to transfer; good faith purchase of goods; "entrusting."

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale," or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the articles on secured transactions (article 9) and documents of title (article 7). (1965, c. 700, s. 1; 2004-190, s. 3.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 20(4), 23, 24, 25, Uniform Sales Act; Section 9, especially 9(2), Uniform Trust Receipts Act; Section 9, Uniform Conditional Sales Act.

Changes: Consolidated and rewritten.

Purposes of Changes: To gather together a series of prior uniform statutory provisions and the case law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under subsection (1). In this respect the provisions of the section are applicable to a person taking by any form of "purchase" as defined by this Act. Moreover the policy of this Act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based or statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier Factors Acts. In addition subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsections (2)-(4) into a single principle protecting persons who buys in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in subsection (3) to fit with the abolition of the old law of "cash sale" by subsection (1) (c). It it also freed from any technicalities depending on the extended law of larceny; such extension of the concept of theft to include trick, particular types of fraud, and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of Section 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (Section 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of overtechnical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. Section 1-201(9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in subsection (1), the rights of purchasers other than buyers in ordinary course are left to the Articles on Secured Transactions, Documents of Title, and Bulk Sales.

Cross References:

Point 1: Sections 1-103 and 1-201.

Point 2: Sections 1-201, 2-402, 7-205 and 9-307(1).

Points 3 and 4: Sections 1-102, 1-201, 2-104, 2-707 and Articles 6, 7 and 9.

Definitional Cross References:

"Buyer in ordinary course of business". Section 1-201.

"Good faith". Sections 1-201 and 2-103.

"Goods". Section 2-105.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Signed". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1): The first sentence of subsection (1), which relates to persons who are not "merchants," accords with prior North Carolina law that the fact that the owner has entrusted the mere possession and control of personal property to another is ordinarily insufficient to estop him from asserting his title against a person who has dealt with the possessor on the faith of his apparent ownership or authority to sell. But if the seller, in addition to mere possession, is given indicia of title by the true owner or the true owner by his conduct clothes the possessor with apparent title or apparent power of disposition, third parties who are induced to deal with the possessor shall be protected. See Handley Motor Co. v. Wood, 237 N.C. 318, 75 S.E.2d 312 (1953); Wilson v. Commercial Fin. Co., 239 N.C. 349, 79 S.E.2d 908 (1953).

The second provision of this subsection changes North Carolina law. While subsection (1)(a) has no case or statutory parallel in North Carolina, subsection (1)(b) is contrary to prior North Carolina law. In North Carolina if a buyer gave a bad check which was dishonored, the buyer took *no* title and could not convey a good title to a bona fide purchaser. See Wilson v. Commercial Fin. Co., 239 N.C. 349, 79 S.E.2d 908 (1953). If the seller who took a bad check, however, gave to the buyer an indicium of title upon which a bona fide purchaser subsequently relies, the seller would be estopped to asset his title as against the bona fide purchaser. Wilson v. Commercial Fin. Co., 239 N.C. 349, 79 S.E.2d 908 (1953); Handley Motor Co. v. Wood, 237 N.C. 318, 75 S.E.2d 312 (1953).

This UCC provision, subsection (1)(b), permits a buyer, who has procured delivery of goods by a check that is later dishonored, to transfer good title to a good faith purchaser for value. The result of the UCC provision is to make the title procured on a bad or worthless check a "voidable" title; before the seller avoids the transaction, the holder of such "avoidable" title can convert it into a "good" title by selling it to a bona fide purchaser for value from whom it cannot be recovered. North Carolina law is materially changed.

Subsection (1)(c) also changes North Carolina law. In North Carolina if a sales contract contemplated a "cash sale," that payment of cash and delivery of goods were to be simultaneous as a condition precedent to the passage of title, mere delivery passed no title but passed only possession if the buyer did not pay. The case of Green River Land Co. v. Bostic, 168 N.C. 99, 83 S.E. 747 (1914) held that a buyer in a "cash sale" gets no title and getting none has only possession of the goods and can pass no title to another purchaser. Compare Millhiser v. Endman, 98 N.C. 292, 3 S.E. 521 (1887).

Subsection (1)(d) is likewise probably contrary to prior North Carolina law. Compare Ellison v. Hunsinger, 237 N.C. 619, 75 S.E.2d 884 (1953), which indicates approval of the law of South Carolina that a defrauded owner can recover goods from a bona fide purchaser from one who has obtained them from the true owner by false pretense punishable as a crime. While the case cited applied South Carolina law, the North Carolina court indicated approval. The UCC protects a bona fide purchaser who has bought from one who obtained delivery through fraud even though such fraud is punishable as larcenous under the criminal law. Compare former GS 27-51 of the Uniform Warehouse Receipts Act which is like the UCC in principle on this point.

Subsection (2) which relates to persons who are "merchants" changes North Carolina law. Prior North Carolina law provided that the fact that an owner has entrusted someone with mere possession and control of personal property would not, without more, estop the owner from asserting his title against one who had bought from such possessor (in the absence of some estoppel factor). The UCC, however, protects any purchaser who has bought in the ordinary curse of business any item entrusted to a "merchant" who deals in goods of the kind entrusted, whether the merchant had any apparent authority to sell or whether or not there was any indicium of title.

Caveat: Subsection (2) changes North Carolina law. Will it be safe to leave an item, say a watch or used car, to be repaired if the jeweler or car repairer deals in the sale of used watches or cars in the ordinary course of business?

The UCC specifies different rules for merchants.

Subsection (3) defines entrusting and allows no conditions to defeat the other rules.

Subsection (4) states that creditors' rights are found in other sections, e.g., GS 25-2-403, relating only to purchasers.

Legal Periodicals. — For article, "The Contracts of Minors Viewed from the Perspective of Fair Exchange," see 50 N.C.L. Rev. 517 (1972).

For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

For comment, "Entrustment Under U.C.C. Section 2-403 and Its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

For note, "Stolen Artwork: Deciding Ownership is no Pretty Picture," see 1993 Duke L.J. 337.

CASE NOTES

"Good faith" in the context of this section means "honesty in fact" in the transaction involved. Landrum v. Armbruster, 28 N.C. App. 250, 220 S.E.2d 842 (1976).

Three essential elements must be present to make this section operative: (1) an entrustment of goods to (2) a merchant dealing in goods of that kind, followed by a sale by that merchant to (3) a buyer in the ordinary course of business. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

The basic predicate for the operation of subsection (1) of this section is title, either actual or voidable, in the transferee. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

And Unauthorized Transfer by Bailee Will Not Divest Bailor of Title. — In the absence of grounds for an estoppel and except as provided in subsection (2) of this section or § 25-2-401, no right, title, or interest may be acquired as the result of an unauthorized or wrongful sale, gift, exchange, pledge, mortgage, or other transfer of property by a bailee in possession, even though to an innocent purchaser. The bailor is not divested of his title by such an unauthorized act and may recover the property or its value from the vendee or transferee in any appropriate form of action. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

Where an entrustment does not qualify under subsection (2) of this section, precode law will be applicable in determining the rights of the parties. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

For subsection (2) to be applicable, there must be three essential steps: (1) an entrustment of goods to (2) a merchant who deals in goods of that kind followed by a sale by such merchant to (3) a buyer in ordinary course of business. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970); American Clipper Corp. v. Howerton, 311 N.C. 151, 316 S.E.2d 186 (1984).

The phrase "deals in goods" in subsection (2) of this section is to be construed as one who is engaged regularly in selling goods of the kind. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

"Buyer in Ordinary Course of Business". — A company is not a "buyer in ordinary course of business," a purchaser who bought goods in the open market, if it did not acquire possession of the goods as a purchaser in the ordinary course of business, but received those goods in its capacity as a textile finisher, for the specific purpose of processing them on behalf of the owner. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

Power of Entrustee. — Where all the essential elements of subsection (2) of this section were satisfied, the entrustee had the power, under the statute, to transfer such title as the entruster possessed. American Clipper Corp. v. Howerton, 311 N.C. 151, 316 S.E.2d 186 (1984).

Sale by the entrustee makes a definitive transfer of the entruster's title. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Title passes once a sale has been made by the entrustee to a buyer in ordinary course of business, from the entruster to the buyer. The entruster no longer has title. The buyer then has the power to transfer to another the interest he received in the goods. American Clipper Corp. v. Howerton, 311 N.C. 151, 316 S.E.2d 186 (1984).

Buyer with Voidable Title Can Transfer Better Title Than He Had. — While the buyer might have had a voidable title if he had made fraudulent representations of solvency, one with voidable title can transfer better title than he had under this section. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

The holder of a perfected security interest in after acquired property is a "good faith purchaser" whose rights are superior to a seller of the after acquired goods under § 25-2-702(2), several commentators have concluded. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

Vendee Who Paid with Forged Check May Transfer Good Title. — Whether a check was a forgery, the transaction a cash sale or whether delivery was procured through fraud punishable as larcenous under the criminal law, contrary to the law as it may have been prior to the enactment of this section, the vendee in such a transaction may transfer a good title to a "good faith purchaser for value." Lane v. Honeycutt, 14 N.C. App. 436, 188 S.E.2d 604, cert. denied, 281 N.C. 622, 190 S.E.2d 466 (1972).

Dishonored checks. — This section allows a person who has obtained delivery of goods under a transaction of purchase to transfer a good title to a "good faith purchaser for value" even though such person obtained delivery in exchange for a check which is later dishonored or procured the delivery through criminal fraud. Landrum v. Armbruster, 28 N.C. App. 250, 220 S.E.2d 842 (1976).

A vehicle dealer who sold a vehicle to a private consumer, who paid with a dishonored check, effectively placed the car into the stream of commerce to the extent that a second car dealer, who purchased the car from the buyer, could be construed as a good-faith purchaser of the car in spite of the fact that the first dealer never provided the consumer with a certificate of title. Sale Chevrolet, Buick, BMW, Inc. v. Peterbilt of Florence, Inc., 133 N.C. App. 177, 514 S.E.2d 747 (1999).

Original Transferor Held Entitled to Follow Proceeds of Resale. — Where the trial court found upon supporting evidence that original defendant paid for pigs purchased from plaintiff with a draft which was returned for insufficient funds, that additional defendants knew that original defendant had not paid plaintiff for the pigs and would not be able to do so and that plaintiff was seeking recovery of the purchase price or the pigs, and that the additional defendants were not purchasers of the pigs but acted as agent for the original defendant when they thereafter sold the pigs to third parties and applied the proceeds of the sale to debts owed by the original defendant to the additional defendants, the trial court properly held that title to the pigs remained in plaintiff, that plaintiff was entitled to follow the proceeds of the sale of the pigs, and that additional defendants were secondarily liable to plaintiff for the value of the pigs disposed of up to the balance of the purchase price due for the pigs. Gus Z. Lancaster's Stock Yards, Inc. v. Williams, 37 N.C. App. 698, 246 S.E.2d 823, cert. denied, 295 N.C. 738, 248 S.E.2d 863 (1978).

UCC Controls Issues of Security Interests and Priorities Involving Motor Vehicles. — Notwithstanding the title transfer provisions of the Motor Vehicle Act, an automobile purchaser may be a "buyer in the ordinary course of business" as that term is used in this section and G.S. 25-9-307, even though the certificate of title has not yet been reassigned. Moreover, it was the Legislature's intent to have the UCC control issues of security interests and priorities. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

The UCC should control over the Motor Vehicle Act when automobiles are used as collateral and are held in inventory for sale. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Buyers who gave value for a used car displayed on dealer's lot and received a 20-day temporary marker in June, 1983, which car was covered by a dealer inventory security agreement in effect since April 1, 1970, and on which the credit company retained the title certificate, which was in the name of the dealer, had a superior right to possession of the car when the credit company's agent came to repossess it on June 19, 1983, as it was no longer part of the dealer's inventory; and buyers were entitled to possession of the car in their action for wrongful conversion. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Burden of proof of transfer of good title rests upon party making later purchase. Landrum v. Armbruster, 28 N.C. App. 250, 220 S.E.2d 842 (1976).

To prevail the subsequent purchaser must prove (1) that he was a purchaser, (2) that he purchased in good faith and (3) that he gave value. Landrum v. Armbruster, 28 N.C. App. 250, 220 S.E.2d 842 (1976).

Failure to Raise Question of Applicability of Section in Trial Court. — The fact that the applicability of this section of the Uniform Commercial Code to a proceeding has not been brought to the attention of the district court on motion for judgment n.o.v. does not in all instances preclude appellate review. Toyomenka, Inc. v. Mount Hope Fin. Co., 432 F.2d 722 (4th Cir. 1970).

Cited in North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985); Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

PART 5.

PERFORMANCE.

§ 25-2-501. Insurable interest in goods; manner of identification of goods.

(1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

(a) when the contract is made if it is for the sale of goods already existing and identified;

(b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;

(c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law. (1965, c. 700, s. 1; 1967, c. 24, s. 8.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Sections 17 and 19, Uniform Sales Act.

Purposes:

1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced — as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

6. Identification of crops under paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly excludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the concept of "growing". Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

Cross References:

Point 1: Section 2-502.
Point 4: Sections 2-509, 2-510 and 2-703.
Point 5: Sections 2-105, 2-308, 2-503 and 2-509.
Point 6: Sections 2-105(1), 2-107(1) and 2-402.

Definitional Cross References:

"Agreement". Section 1-201.
"Contract for sale". Section 2-106.
"Future goods". Section 2-105.
"Goods". Section 2-105.
"Notification". Section 1-201.
"Party". Section 1-201.
"Sale". Section 2-106.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1): It is believed that subsection (1) accords with prior North Carolina law although there are neither cases nor decisions exactly in point.

North Carolina law stated that a person had an insurable interest in subject matter if he had such a relation to, connection with or concern in such subject matter that he would derive pecuniary benefits or advantage from its preservation or would suffer pecuniary loss from its destruction or injury. See King v. National Union Fire Ins. Co., 258 N.C. 432, 128 S.E.2d 849 (1962).

North Carolina law also stated that where a bargain was made for the purchase of goods and nothing was said about payment or delivery, the property passed immediately, so as to cast on the purchaser all future risk, if nothing remained to be done to the goods, although he could not take them away without paying the price. Richardson v. Insurance Co. of North America, 136 N.C. 314, 48 S.E. 733 (1904). If the goods were on hand at the time the contract was made, title passed upon the making of the contract. Teague v. Howard Grocery Co., 175 N.C. 195, 95 S.E. 173 (1918). Neither delivery nor payment of the price was necessary to pass title. Winborne v. McMahon, 206 N.C. 31, 173 S.E. 1 (1934); Jenkins v. Jarrett, 70 N.C. 255 (1874).

It followed that a buyer under a contract of sale of ascertained specified goods had an insurable interest in the goods in North Carolina under prior law.

If something remained to be done to the goods, or they were not specifically identified or ascertained, title remained in the seller. See Blakely v. Patrick, 67 N.C. 40 (1872). In such case the seller, and not the buyer, would have had the insurable interest in the goods. Richardson v. Insurance Co. of North America, 136 N.C. 314, 48 S.E. 733 (1904). A separation or marking of the goods would sufficiently identify them. See Pitts v. Curtis, 152 N.C. 615, 68 S.E. 189 (1910).

Subsection (2), giving seller insurable interest, also accords with King v. National Union Fire Ins. Co., 258 N.C. 432, 128 S.E.2d 849 (1962). So long as the seller has a pecuniary interest in the goods, such as his seller's lien for the price, possible liability for negligence in their destruction, etc., he should have an insurable interest in the goods.

There is no real difference in results as to insurable interest as a consequence of adoption of the UCC. Under the UCC, as under prior insurance theory, the question of whether title has or has not passed from the seller to the buyer need not be determined.

CASE NOTES

Sale of Lumber or Growing Timber. — The comments to this section plainly state that lumber or growing timber is not a crop, and further state that where the "buyer (has the power) to select the goods," this is an explicit agreement which displaces the rules of subdivisions (1)(a), (1)(b) and (1)(c) of this section. Fisher v. Elmore, 610 F. Supp. 123 (E.D.N.C. 1985), aff'd, 802 F.2d 771 (4th Cir. 1986).

For discussion of identification of goods when buyer has contract to enter, cut, harvest and remove pulpwood or logs, see Fisher v. Elmore, 610 F. Supp. 123 (E.D.N.C. 1985), aff'd, 802 F.2d 771 (4th Cir. 1986).

Applied in Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983).

Cited in Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986); In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-502. Buyer's right to goods on seller's repudiation, failure to deliver, or insolvency.

(1) Subject to subsections (2) and (3) of this section and even though the goods have not been shipped, a buyer who has paid a part or all of the price of goods in which he has a special property under G.S. 25-2-501 may, on making and keeping good a tender of any unpaid portion of their price, recover them from the seller if:

a. in the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by the contract; or

b. in all cases, the seller becomes insolvent within 10 days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under subdivision (1)a. of this section vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his special property has been made by the buyer, he acquires the right to recover the goods only if they conform to the contract for sale. (1965, c. 700, s. 1; 2000-169, s. 11.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Prior Uniform Statutory Provision:
Compare Sections 17, 18 and 19, Uniform Sales Act.

Purposes:

1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2-501. The buyer is given a right to recover the goods, conditioned upon making and keeping good a tender of any unpaid portion of the price, in two limited circumstances. First, the buyer may recover goods bought for personal, family, or household purposes if the seller repudiates the contract or fails to deliver the goods. Second, in any case, the buyer may recover the goods if the seller becomes insolvent within 10 days after the seller receives the first installment on their price. The buyer's right to recover the goods under this section is an exception to the usual rule, under which the disappointed buyer must resort to an action to recover damages.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).

3. Under subsection (2), the buyer's right to recover consumer goods under subsection (1)(a) vests upon acquisition of a special property, which occurs upon identification of the goods to the contract. See Section 2-501. Inasmuch as a secured party normally acquires no greater rights in its collateral that its debtor had or had power to convey, see Section 2-403(1) (first sentence), a buyer who acquires a right to recover under this section will take free of a security interest created by the seller if it attaches to the goods after the goods have been identified to the contract. The buyer will take free, even if the buyer does not buy in ordinary course and even if the security interest is perfected. Of course, to the extent that the buyer pays the price after the security interest attaches, the payments will constitute proceeds of the security interest.

4. Subsection (3) is included to preclude the possibility of unjust enrichment, which would exist if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

Cross References:
Point 1: Sections 1-201 and 2-702.
Point 2: Article 9.

Definitional Cross References:
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Insolvent". Section 1-201.
"Right". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions directly in point.

There is, however, one North Carolina case which reaches a result similar to the result that will be reached under subsection (1). Teague v. Howard Grocery Store, 175 N.C. 195, 95 S.E. 173 (1918), provides that a purchaser who contracts for specified goods which are not delivered by the seller, but which are in his possession when he makes an assignment for the benefit of creditors, becomes titleholder of the specified goods and can take possession of the specified goods against the seller's creditors; that such does not constitute a preference.

The same result is applicable under the Code where all or part payment for identified goods has been made. The buyer is entitled to recover the goods themselves and is not relegated to a position of only a general creditor. Determination of title is not necessary under the Code.

There was no North Carolina parallel to subsection (2), either by statute or decision.

CASE NOTES

Seller Must Become Insolvent Within 10 Days after Receipt of First Installment of Purchase Price. — Presumably, a seller cannot become insolvent prior to the receipt of the first installment of the purchase price or 11 days after receipt of the first installment of the purchase price or on the very date of its receipt. He has to become insolvent within the given 10-day period. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

Applied in Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983).

Cited in In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-503. Manner of seller's tender of delivery.

(1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this article, and in particular

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section [G.S. 25-2-504] respecting shipment tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (1) and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a non-negotiable document of title or of a record directing the bailee to deliver is sufficient tender unless the buyer seasonably objects, and, except as otherwise provided in Article 9 of this Chapter, receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents

(a) he must tender all such documents in correct form, except as provided in this article with respect to bills of lading in a set (subsection (2) of G.S. 25-2-323); and

(b) tender through customary banking channels is sufficient and dishonor of a draft accompanying or associated with the documents constitutes non-acceptance or rejection. (1965, c. 700, s. 1; 2006-112, s. 32.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 11, 19, 20, 43 (3) and (4), 46 and 51, Uniform Sales Act.

Changes: The general policy of the above sections is continued and supplemented but subsection (3) changes the rule of prior section 19(5) as to what constitutes a "destination" contract and subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

Purposes of Changes:

1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this Article in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and must be followed by actual performance if the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this Article and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect when measured against the contract obligation. Used in either sense, however, "tender" connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner.

2. The seller's general duty to tender and

deliver is laid down in Section 2-301 and more particularly in Section 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by Section 1-205. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this Article on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under subsection (1) by tendering documents which give the buyer complete control of the goods under the provisions of Article 7 on due negotiation.

3. Under paragraph (a) of subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under subsection (1), paragraph (b). This obligation of the buyer is no part of the seller's tender.

5. For the purposes of subsections (2) and (3) there is omitted from this Article the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this Article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of subsection (4) continues the rule of the prior uniform legislation as to acknowledgement by the bailee. Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under subsection (5) documents are never "required" except where there is an express contract term or it is plainly implicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": All documents must be in correct form.

When a prescribed document cannot be procured, a question of fact arises under the provision of this Article on substituted performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

Cross References:

Point 2: Sections 1-205, 2-301, 2-310, 2-507 and 2-513 and Article 7.

Point 5: Sections 2-308, 2-310 and 2-509.

Point 7: section 2-614(1).

Specific matters involving tender are covered in many additional sections of this Article. See Sections 1-205, 2-301, 2-306 to 2-319, 2-321(3), 2-504, 2-507(2), 2-511(1), 2-513, 2-612 and 2-614.

Definitional Cross References:

"Agreement". Section 1-201.
"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Dishonor". Section 3-508.
"Document of title". Section 1-201.
"Draft". Section 3-104.
"Goods". Section 2-105.
"Notification". Section 1-201.
"Reasonable time". Section 1-204.
"Receipt" of goods. Section 2-103.
"Rights". Section 1-201.
"Seasonably". Section 1-204.
"Seller". Section 2-103.
"Written". Section 1-201.

NORTH CAROLINA COMMENT

The first sentence of subsection (1) apparently accords with prior North Carolina law. See Williams v. Johnston, 26 N.C. 233 (1844), that the seller has the duty to notify the buyer when delivery will take place when the time for delivery is not set out in the contract.

Subsections (1)(a) and (b), defining the time and place for tender have no North Carolina parallels, although proper tender for purposes of the NIL was set out in GS 25-78 et seq.

The remaining subsections setting out the details required for valid tender have no counterparts in prior North Carolina law and are therefore new.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 32, effective October 1, 2006, in subdivision (4)(b), substituted "record directing" for "written direction to" near the beginning, and inserted "except as otherwise provided in Article 9 of this Chapter"; and inserted "or associated with" in subdivision (5)(b).

CASE NOTES

Applied in Bernick v. Jurden, 306 N.C. 435, 293 S.E.2d 405 (1982).

§ 25-2-504. Shipment by seller.

Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 46, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that:

1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located. The general principles embodied in this section cover the special case of F. O. B. point of shipment contracts and C. I. F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier

under paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this Article on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this Article on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this Article on options and co-operation respecting performance gives the seller the choice of any reasonable carrier, routing and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances, such as refrigeration, watering of livestock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and delivery promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of paragraph (b) unless the contract requires some other form of document.

5. This Article, unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt forwarding of the documents as under paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

Cross References:

Point 1: Sections 2-319, 2-320 and 2-503(2).

Point 2: Sections 1-203, 2-323(2), 2-601 and 2-614(1).

Point 3: Section 2-311(2).

Point 5: Section 1-203.

Definitional Cross References:

"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Goods". Section 2-105.
"Notifies". Section 1-201.
"Seller". Section 2-103.
"Send". Section 1-201.
"Usage of trade". Section 1-205.

NORTH CAROLINA COMMENT

Subsection (a) accords with prior North Carolina law that if seller is to ship goods but no carrier is designated, it is the duty of the seller to ship in a reasonable course of transit. See G. Ober & Son v. Smith, 78 N.C. 313 (1878).

Subsection (b), however, does not accord with G. Ober & Son v. Smith, 78 N.C. 313 (1878), which states that bills of lading or other documentary indicia of title need not be sent by the seller to the purchaser.

Subsection (c) also does not accord with prior North Carolina law as set out in G. Ober & Son v. Smith, 78 N.C. 313 (1878). That case held that it was not necessary for the seller to give notice of the shipment in order to shift title and the risk of loss to the buyer.

This section changes North Carolina law but not in any significant way that will vary commercial practice.

Legal Periodicals. — For survey of 1981 commercial law, see 60 N.C.L. Rev. 1238 (1982).

CASE NOTES

"Prompt Notice" Generally. — The requirement of prompt notification by the seller, as used in this section, must be construed as taking into consideration the need of a buyer to be informed of the shipment in sufficient time for him to take action to protect himself from the risk of damage to or loss of the goods while in transit. Rheinberg-Kellerei GMBH v. Vineyard Wine Co., 53 N.C. App. 560, 281 S.E.2d 425, cert. denied, 304 N.C. 588, 289 S.E.2d 564 (1981).

Relationship Between Prompt Notice and Risk of Loss. — Seller's failure to notify the buyer of shipment of wine from Germany until after the sailing of the ship and the ensuing loss was not "prompt notice" within the meaning of this section, and therefore the risk of loss did not pass to the buyer upon the delivery of the wine to the carrier pursuant to the provisions of G.S. 25-2-509(1)(a). Rheinberg-Kellerei GMBH v. Vineyard Wine Co., 53 N.C. App. 560, 281 S.E.2d 425, cert. denied, 304 N.C. 588, 289 S.E.2d 564 (1981).

§ 25-2-505. Seller's shipment under reservation.

(1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) a nonnegotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of G.S. 25-2-507) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession or control of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within G.S. 25-2-504 but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document of title. (1965, c. 700, s. 1; 2006-112, s. 33.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 20(2), (3), (4), Uniform Sales Act.

Changes: Completely rephrased, the "powers" of the parties in cases of reservation being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of Changes: To continue in general the policy of the prior uniform statutory provision with certain modifications of emphasis and language, so that:

1. The security interest reserved to the seller under subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this Article, the provision as to the passing of interest expressly applies

"despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in subsection (1) are not to be altered by any apparent "contrary intent" of the parties as to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this Article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This Article does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under subsection (1) paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This Article does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the Article on Documents of Title (Article 7).

3. A non-negotiable bill of lading taken to a party other than the buyer under subsection (1) paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by non-negotiable bill of lading taken to a buyer, the seller, under subsection (1) retains no security interest or possession as against the buyer and by the shipment he *de facto* loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under Section 2-403.

5. Under subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as result from identification of the goods. The security title reserved by the seller under subsection (1) does not protect his holding of the document or the goods for the purpose of exacting more than is due him under the contract.

Cross References:

Point 1: Section 1-201.
Point 2: Article 7.
Point 3: Sections 2-501(2) and 2-504.
Point 4: Sections 2-403, 2-507(2) and 2-705.
Point 5: Sections 2-310, 2-319(4), 2-320(4), 2-501 and 2-502 and Article 7.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Buyer". Section 2-103.
"Consignee". Section 7-102.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Financing agency". Section 2-104.
"Goods". Section 2-105.
"Holder". Section 1-201.
"Person". Section 1-201.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Under prior North Carolina law procurement by seller of a bill of lading in his own name or to his own order reserved title in the seller until the draft attached thereto was paid. Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924). Title was not merely for security purposes but included risk of loss which followed title. See Perriman v. Winder, 180 N.C. 73, 103 S.E. 908 (1920).

This section therefore changes North Carolina law. If seller shipped and had bill of lading made to himself or to his own order, legal title did not pass to the buyer for any purpose (such as risk of loss). Under the UCC, however, by making the bill of lading to his own order, or to the order of one other than the buyer, the seller does not retain legal title to goods shipped, but retains only a "security interest." If goods are destroyed, the risk of loss falls on buyer if the goods conformed. In North Carolina the risk of loss formerly would have fallen on the seller if the bill of lading was to his own order.

Subsection (2) accords with Riley v. Carpenter, 143 N.C. 215, 55 S.E. 628 (1906), that if shipment with reservation of title in seller violates terms of contract, because bill of lading is made out to the order of the seller and not the buyer, it constitutes a breach.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 33, effective October 1, 2006, inserted "or control" near the end of subdivision (1)(b); in subsection (2), substituted "G.S. 25-2-504" for "the preceding section" in the middle, and added "of title" at the end.

§ 25-2-506. Rights of financing agency.

(1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular. (1965, c. 700, s. 1; 2006-112, s. 34.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. "Financing agency" is broadly defined in this Article to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction. The term as used in subsection (1) is not in any sense intended as a limitation and covers any other appropriate situation which may arise outside the scope of the definition.

2. "Paying" as used in subsection (1) is typified by the letter of credit, or "authority to pay" situation in which a banker, by arrangement with the buyer or other consignee, pays on his behalf a draft for the price of the goods. It is immaterial whether the draft is formally drawn on the party paying or his principal, whether it is a sight draft paid in cash or a time draft "paid" in the first instance by acceptance, or whether the payment is viewed as absolute or conditional. All of these cases constitute "payment" under this subsection. Similarly, "purchasing for value" is used to indicate the whole area of financing by the seller's banker, and the principle of subsection (1) is applicable without any niceties of distinction between "purchase," "discount," "advance against collection" or the like. But it is important to notice that the only right to have the draft honored that is acquired is that *against the buyer;* if any right against any one else is claimed it will have to be under some separate obligation of that other person. A letter of credit does not necessarily protect *purchasers* of drafts. See Article 5. And for the relations of the parties to documentary drafts see Part 5 of Article 4.

3. Subsection (1) is made applicable to payments or advances against a draft which "relates to" a shipment of goods and this has been chosen as a term of maximum breadth. In particular the term is intended to cover the case of a draft against an invoice or against a delivery order. Further, it is unnecessary that there be an explicit assignment of the invoice attached to the draft to bring the transaction within the reason of this subsection.

4. After shipment, "the rights of the shipper in the goods" are merely security rights and are subject to the buyer's right to force delivery upon tender of the price. The rights acquired by the financing agency are similarly limited and, moreover, if the agency fails to procure any outstanding negotiable document of title, it may find its exercise of these rights hampered or even defeated by the seller's disposition of the document to a third party. This section does not attempt to create any new rights in the financing agency against the carrier which

would force the latter to honor a stop order from the agency, a stranger to the shipment, or any new rights against a holder to whom a document of title has been duly negotiated under Article 7.

Cross References:

Point 1: Section 2-104(2) and Article 4.

Point 2: Part 5 of Article 4, and Article 5.

Point 4: Sections 2-501 and 2-502(1) and Article 7.

Definitional Cross References:

"Buyer". Section 2-103.
"Document of title". Section 1-201.
"Draft". Section 3-104.
"Financing agency". Section 2-104.
"Good faith". Section 2-103.
"Goods". Section 2-105.
"Honor". Section 1-201.
"Purchase". Section 1-201.
"Rights". Section 1-201.
"Value". Section 1-201.

NORTH CAROLINA COMMENT

There is no statutory or case law exactly in point. While under prior North Carolina law a bank or financing agency could purchase a bill of lading by discounting draft attached and receive seller's title, the UCC by subsection (1) of this section gives the financing agency in such case only a "security interest."

Subsection (2) follows the policy of the Uniform Bills of Lading Act, GS 21-37, in freeing a person who enters transaction merely as a financer from responsibility for defects in the documents of title or the merchandise therein described. See Mason v. A. E. Nelson Cotton Co., 148 N.C. 492, 62 S.E. 625 (1908).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 34, effective October 1, 2006, substituted "regular" for "regular on its face" in subsection (2).

§ 25-2-507. Effect of seller's tender; delivery on condition.

(1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Sections 11, 41, 42 and 69, Uniform Sales Act.

Purposes:

1. Subsection (1) continues the policies of the prior uniform statutory provisions with respect to tender and delivery by the seller. Under this Article the same rules in these matters are applied to present sales and to contracts for sale. But the provisions of this subsection must be read within the framework of the other sections of this Article which bear upon the question of delivery and payment.

2. The "unless otherwise agreed" provision of subsection (1) is directed primarily to cases in which payment in advance has been promised or a letter of credit term has been included.

Payment "according to the contract" contemplates immediate payment, payment at the end of an agreed credit term, payment by a time acceptance or the like. Under this Act, "contract" means the total obligation in law which results from the parties' agreement including the effect of this Article. In this context, therefore, there must be considered the effect in law of such provisions as those on means and manner of payment and on failure of agreed means and manner of payment.

3. Subsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. The provision of this Article for a ten day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here.

Cross References:

Point 1: Sections 2-310, 2-503, 2-511, 2-601 and 2-711 to 2-713.

Point 2: Sections 1-201, 2-511 and 2-614.

Point 3: Sections 2-401, 2-403 and 2-702(1)(b).

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with the general law of contracts that in the absence of contrary agreement, payment and delivery are concurrent conditions. See McAden v. Craig, 222 N.C. 497, 24 S.E.2d 1 (1942); Wessel v. Seminole Phosphate Co., 13 F.2d 999 (4th Cir. 1926).

Subsection (2) has no statutory or decisional parallel in the prior law of sales.

§ 25-2-508. Cure by seller of improper tender or delivery; replacement.

(1) Where any tender or delivery by the seller is rejected because nonconforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) permits a seller who has made a non-conforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the non-conforming goods and refunded the purchase price. He may still make a good tender within the contract period. The closer, however, it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which

require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare Section 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

Cross References:
Point 2: Section 2-302.
Point 3: Section 2-511.
Point 4: Sections 1-205 and 2-721.

Definitional Cross References:
"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Money". Section 1-201.
"Notifies". Section 1-201.
"Reasonable time". Section 1-204.
"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section has no counterpart in prior North Carolina statutory or decisional law.

CASE NOTES

Seller May Make Conforming Delivery Regardless of Prior Nonconforming Delivery. — It is clear from this section that the seller may at any time before the expiration of the time for performance make a conforming delivery regardless of a prior nonconforming delivery. Meads v. Davis, 22 N.C. App. 479, 206 S.E.2d 868 (1974).

Even Though Seller Knew Prior to Delivery that Goods Were Not in Conformity. — This section deals with the situation in which the seller knows prior to delivery that the goods are not in conformity, but has reason to believe that the buyer will accept. An example of such a situation might be where the buyer orders goods no longer carried by the seller, but the seller has goods which will perform the same function. Meads v. Davis, 22 N.C. App. 479, 206 S.E.2d 868 (1974).

Buyer's Obligation Abrogated after "Reasonable Time". — Where defendants were not able to and did not make a conforming delivery within a "reasonable time" or within the "contract time," the plaintiff buyer had no further obligation to purchase or accept any mobile home from defendants, whether the original unit was in a repaired condition or was a replacement. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Cited in Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

§ 25-2-509. Risk of loss in the absence of breach.

(1) Where the contract requires or authorizes the seller to ship the goods by carrier

(a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (G.S. 25-2-505); but

(b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

(a) on his receipt of possession or control of a negotiable document of title covering the goods; or

(b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) after his receipt of possession or control of a nonnegotiable document of title or other direction to deliver in a record, as provided in subsection (4)(b) of G.S. 25-2-503.

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this article on sale on approval (G.S. 25-2-327) and on effect of breach on risk of loss (G.S. 25-2-510). (1965, c. 700, s. 1; 2006-112, s. 35.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 22, Uniform Sales Act.

Changes: Rewritten, subsection (3) of this section modifying prior law.

Purposes of Changes: To make it clear that:

1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass. To transfer the risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement, the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk.

5. The provisions of this section are made subject by subsection (4) to the "contrary agreement" of the parties. This language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this Act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

Cross References:

Point 1: Section 2-510(1).

Point 2: Sections 2-503 and 2-504.
Point 3: Sections 2-104, 2-503 and 2-510.
Point 4: Section 2-503(4).
Point 5: Section 1-201.

Definitional Cross References:
"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Party". Section 1-201.
"Receipt" of goods. Section 2-103.
"Sale on approval". Section 2-326.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

The prior law provided that risk of loss followed the title. Penniman v. Winder, 180 N.C. 73, 103 S.E. 908 (1920); Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924); Richardson v. Insurance Co. of North America, 136 N.C. 314, 48 S.E. 733 (1904).

This section of the UCC abolishes the traditional "property passage" or "title" approach as regards the question of who bears the risk of loss. Under the Code it is not necessary to make a broad and circuitous search to locate title to determine risk of loss. This Code section provides a direct mode of determining who has the risk of loss by short and concise statements. In most cases the results are the same under both methods.

Subsection (1)(a) provides that if the contract does not require the seller to deliver to a particular destination, risk of loss passes to the buyer when the goods are delivered to the carrier. This accords with the prior North Carolina rule. See Hunter v. Randolph, 128 N.C. 91, 38 S.E. 288 (1901).

But subsection (1)(a) provides that the risk of loss passes to the buyer even if the shipment is under reservation (by reservation of security via bill of lading made to order of seller). This does not accord with prior North Carolina law which held that if seller had procured a bill of lading to seller's order, no title passed by shipment of the goods until the draft accompanying the bill of lading was paid. Thus, if the bill of lading, upon shipment, was made "to seller's order" risk of loss was on the seller. See Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924). *Contra,* Uniform Sales Act, G.S. 20 (2) but North Carolina never adopted the Uniform Sales Act.

Subsection (1)(b) provides that if the contract requires seller to deliver to a particular destination, the goods remain at the seller's risk until they reach their destination. Mere delivery to the carrier does not shift the risk of loss to the buyer. This accords with Peed v. Burleson's, Inc., 244 N.C. 437, 94 S.E.2d 351 (1956). Title remains in the seller until delivery (or tender of delivery) at the rightful place to the buyer. Acme Paper Box Factory v. Atlantic Coast Line R.R., 148 N.C. 421, 62 S.E. 557 (1908). Subsection (1) (b) thus accords with the North Carolina cases in result.

Subsections (2)(a) and (b) provide that risk of loss shall shift if goods are held by bailee and buyer receives documents of title covering goods or bailee acknowledges buyer's right to possess the goods. Compare Williams v. Hodges, 113 N.C. 36, 18 S.E. 83 (1893); Waldo v. Belcher, 33 N.C. 609 (1850); on contract for sale of specific goods, property was transferred unless different intention appears, when contract was made. See Winborne v. McMahon, 206 N.C. 30, 173 S.E. 278 (1934); Teague v. Howard Grocery Store, 175 N.C. 195, 95 S.E. 173 (1918). This would appear to put prior North Carolina law substantially in accord with subsections (2) (a) and (b).

Subsection (3) provides that if seller is "merchant," risk of loss does not pass to buyer until receipt of the goods. If seller is not merchant, risk passes to buyer only upon tender of delivery. This constitutes a basic change in North Carolina law, differentiating merchant sellers from others.

Under prior North Carolina law, risk followed title. On a contract for sale of specific goods title passed when the contract was made. Winborne v. McMahon, 206 N.C. 30, 173 S.E. 278 (1934). On making a contract for specific goods, identified without more for the seller to do, the buyer then had the risk of loss after the contract. This Code provision shifts risk of loss to seller until either receipt of the goods by the buyer or until tender of delivery by the seller. It is thought that this accords more with lay understanding and practice. In addition the seller is likely to be better covered with insurance. The search for title is entirely obviated.

Subsection (4) allows the parties to contract to change risk of loss.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 35, effective October 1, 2006, inserted "possession or control of" in subdivisions (2)(a) and (2)(c); in subdivision (2)(c), deleted "written" preceding "direction to," and substituted "deliver in a record" for "deliver."

Legal Periodicals. — For survey of 1981 commercial law, see 60 N.C.L. Rev. 1238 (1982).

CASE NOTES

Buyer Must Have Reasonable Opportunity to Guard Against Risks. — Where buyer, upon shipment by seller, assumes the perils involved in carriage, he must have a reasonable opportunity to guard against these risks by independent arrangements with the carrier. Rheinberg-Kellerei GMBH v. Vineyard Wine Co., 53 N.C. App. 560, 281 S.E.2d 425, cert. denied, 304 N.C. 588, 289 S.E.2d 564 (1981).

Relationship Between Prompt Notice and Risk of Loss. — Seller's failure to notify buyer of shipment of wine from Germany until after sailing of ship and ensuing loss was not "prompt notice" within the meaning of G.S. 25-2-504, and therefore the risk of loss did not pass to the buyer upon the delivery of the wine to the carrier pursuant to the provisions of subdivision (1)(a) of this section. Rheinberg-Kellerei GMBH v. Vineyard Wine Co., 53 N.C. App. 560, 281 S.E.2d 425, cert. denied, 304 N.C. 588, 289 S.E.2d 564 (1981).

Applied in Roseboro Ford, Inc. v. Bass, 77 N.C. App. 363, 335 S.E.2d 214 (1985).

§ 25-2-510. Effect of breach on risk of loss.

(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make clear that:

1. Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure, waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

Cross Reference:
Section 2-509.

Definitional Cross References:
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) placing the risk of loss on the seller if goods do not conform accords in result with prior North Carolina law which allowed a right of rescission or rejection for noncompliance of the goods to the contract. See Hendrix v. B & L Motors, Inc., 241 N.C. 644, 86 S.E.2d 448 (1955). This would seem to have entitled the buyer to reshift the risk of loss if the goods did not conform to contract as is the effect of this UCC provision.

Subsections (2) and (3) have no statutory or decisional parallels in North Carolina, except that in North Carolina the risk of loss would have been on the buyer if the buyer repudiated contract even though the goods conformed to the terms of the contract.

CASE NOTES

Buyer Held Not Liable for Loss of Nonconforming Cable. — In an action to recover the sales price of nonconforming cable which was rejected by the buyer and which was stolen from the buyer's storage space three months after the buyer gave notice of rejection, where the buyer did not contract to return the cable and was not negligent in storing it, the trial court properly concluded that the buyer was not liable for the resulting loss. Graybar Elec. Co. v. Shook, 283 N.C. 213, 195 S.E.2d 514 (1973).

§ 25-2-511. Tender of payment by buyer; payment by check.

(1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this chapter on the effect of an instrument on an obligation (G.S. 25-3-310), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment. (1965, c. 700, s. 1; 1995, c. 232, s. 5.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
Section 42, Uniform Sales Act.

Changes: Rewritten by this section and Section 2-507.

Purposes of Changes:

1. The requirement of payment against delivery in subsection (1) is applicable to noncommercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of

appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the Article dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery" integrates this section with the langauge and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This Article determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment may be demanded before inspection by the buyer.

3. The essence of the principle involved in subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This Article recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article 3 (Section 3-802). Similarly the reason of this subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of the Article on Commercial Paper. (Section 3-802). But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (Section 3-411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check postdated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As between the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

Cross References:

Point 1: Sections 2-307, 2-310, 2-320, 2-325, 2-503, 2-513 and 2-609.

Point 2: Sections 2-307, 2-310, 2-319, 2-322, 2-503, 2-504 and 2-513.

Point 3: Section 2-614.

Point 5: Article 3, esp. Sections 3-802 and 3-411.

Point 6: Sections 2-507, 2-702, and Article 3.

Definitional Cross References:

"Buyer". Section 2-103.
"Check". Section 3-104.
"Dishonor". Section 3-508.
"Party". Section 1-201.
"Reasonable time." Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) makes tender of payment by the buyer a condition precedent to seller's duty to deliver. The Code requires the buyer to do the first act. Prior North Carolina law made the payment of money and the delivery of property simultaneous or concurrent acts. See McAden v. Craig, 222 N.C. 497, 24 S.E.2d 1 (1942). Hughes v. Knott, 138 N.C. 105, 50 S.E. 586 (1905), said that payment of the price must be either precedent or concurrent to delivery.

Subsection (2) is in accord with Hughes v. Knott, 138 N.C. 105, 50 S.E. 586 (1905), which says that a custom of accepting checks as payment for goods in particular trades can be shown and if the check is refused as payment the buyer shall have a reasonable time to convert his funds into currency and that this will be a valid tender of performance by the buyer.

Subsection (3), which states that payment by check is only conditional, accords with prior North Carolina law. See Weddington v.

Boshamer, 237 N.C. 556, 75 S.E.2d 530 (1953); Central Nat'l Bank v. Rich, 256 N.C. 324, 123 S.E.2d 811 (1961); Carrow v. Weston, 247 N.C. 735, 102 S.E.2d 134 (1958); Wilson v. Commercial Fin. Co., 239 N.C. 349, 79 S.E.2d 908 (1953); Handley Motor Co. v. Wood, 237 N.C. 318, 75 S.E.2d 312 (1953), which hold that title does not pass by acceptance of check until it is paid by the bank on which it is drawn. The seller may reclaim goods sold to the buyer in case the check is not paid on due presentation.

CASE NOTES

Applied in Berube v. Mobile Homes Sales & Serv., 28 N.C. App. 160, 220 S.E.2d 636 (1975).

§ 25-2-512. Payment by buyer before inspection.

(1) Where the contract requires payment before inspection nonconformity of the goods does not excuse the buyer from so making payment unless

(a) the nonconformity appears without inspection; or

(b) despite tender of the required documents the circumstances would justify injunction against honor under this chapter (G.S. 25-5-109(b)).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies. (1965, c. 700, s. 1; 1999-73, s. 3.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None, but see Sections 47 and 49, Uniform Sales Act.

Purposes:

1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. "Inspection" under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on common sense and normal commercial practice. The apparent non-conformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. Section 5-114 [5-109].

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by the seller. The remedies preserved to the buyer are all of his remedies which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present section must therefore be considered in conjunction with the provision on right to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

Cross References:
Point 4: Article 5.
Point 5: Section 1-207.
Point 6: Section 2-513(3).

Definitional Cross References:
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Financing agency". Section 2-104.
"Goods". Section 2-105.
"Remedy". Section 1-201.
"Rights". Section 1-201.

NORTH CAROLINA COMMENT

There is apparently no statutory or decisional law in North Carolina in relation to this section, but it seems to accord with "common sense and normal commercial practice" and would probably have been the law in North Carolina.

CASE NOTES

Mere fact that plaintiff paid before delivery does not constitute acceptance of goods or impair buyer's right to inspect or any of his remedies. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

A buyer's down payment on goods does not impair his right to inspect following delivery. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

§ 25-2-513. Buyer's right to inspection of goods.

(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this article on C.I.F. contracts (subsection (3) of G.S. 25-2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides

(a) for delivery "C.O.D." or on other like terms; or

(b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 47(2), (3), Uniform Sales Act.

Changes: Rewritten, subsections (2) and (3) being new.

Purposes of Changes and New Matter: To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that:

1. The buyer is entitled to inspect goods as provided in subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations as those outlined in subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right to the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may, unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to

inspect after receipt of the goods unless the case falls within subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly arrive and be tendered while the goods are still in transit.

This Article recognizes no exception in any peculiar case in which the goods happen to arrive before the documents. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be held until arrival the buyer is entitled to inspect before payment since the goods are then "available for inspection". Proof of usage is not necessary to establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under subsection (3)(b). This result is reinforced by the buyer's right under subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this Article.

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this Article if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this Article which requires that such a time limitation must be reasonable.

8. Inspection under this Article is not to be regarded as a "condition precedent to the passing of title" so that risk until inspection remains on the seller. Under subsection (4) such an approach cannot be sustained. Issues between the buyer and seller are settled in this Article almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

Cross References:

Generally: Sections 2-310 (b), 2-321(3) and 2-606(1) (b).

Point 1: Section 2-607.
Point 2: Sections 2-501 and 2-502.
Point 4: Section 2-715.
Point 5: Section 2-321(3).

Point 6: Sections 2-606 to 2-608.
Point 7: Section 1-204.
Point 8: Comment to Section 2-401.
Point 9: Section 2-316(2) (b).

Definitional Cross References:
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Presumed". Section 1-201.
"Reasonable time". Section 1-204.
"Rights". Section 1-201.
"Seller". Section 2-103.
"Send". Section 1-201.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1), giving buyer right to inspect goods, is in accord with Parker v. Fenwick, 138 N.C. 209, 50 S.E. 630 (1905), and Standard Paint & Lead Works v. Spruill, 186 N.C. 68, 118 S.E. 891 (1923). The latter case states: "Under an executory contract for the sale and delivery of goods of a specified quality, the quality is a part of the description, and the seller is bound to furnish goods actually complying with such description. If he tenders articles of inferior quality, the vendee is not bound to accept them, and unless he does so, he is not liable therefor. This necessarily gives to the vendee the right of inspection, and he must be given an opportunity to make such inspection before becoming liable for the purchase price, unless the contract otherwise provides." "A vendee of merchandise shipped from a distant point, under a contract specifying the quality of the merchandise and providing for its delivery F.O.B. at the point of shipment, but which contains no provisions as to the time or place of payment, inspection or acceptance, is entitled to a reasonable time after the merchandise arrives at its destination in which to inspect it at that point, and to reject it if it does not comply with the contract."

Subsections (2) to (4): There are apparently no direct parallels in prior North Carolina law, either by statutes or decision, to subsections (2), (3) and (4).

CASE NOTES

Buyer Has Reasonable Time After Arrival to Inspect. — Unless otherwise agreed, when the seller is required to send the goods to the buyer, the inspection may be after their arrival, and the buyer is entitled to a reasonable time after the goods arrive at their final destination to inspect and reject them if they do not comply with the contract. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Applied in Graybar Elec. Co. v. Shook, 17 N.C. App. 81, 193 S.E.2d 392 (1972).

§ 25-2-514. When documents deliverable on acceptance; when on payment.

Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 41, Uniform Bills of Lading Act.

Changes: Rewritten.

Purposes of Changes: To make the provision one of general application so that:

1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in Sections 4-503 and 5-112.

2. An "arrival" draft is a sight draft within the purpose of this section.

Cross References:
Point 1: See Sections 2-502, 2-505(2), 2-507(2), 2-512, 2-513, 2-607 concerning protection of rights of buyer and seller, and 4-503 and 5-112 on delivery of documents.

Definitional Cross References:
"Delivery". Section 1-201.
"Draft". Section 3-104.

NORTH CAROLINA COMMENT

North Carolina had no statute or case law corresponding to this section. Although North Carolina adopted the Uniform Bills of Lading Act in 1919, G.S. 41 of the act was omitted. Its terms are set out below:

"§41. Demand, presentation or sight draft must be paid, but draft on more than three days time merely accepted before buyer is entitled to the accompanying bill. — Where the seller of goods draws on the buyer for the price of the goods and transmits the draft and a bill of lading for the goods whether directly to the buyer or through a bank or other agency, unless a different intention on the part of the seller appears, the buyer and all other parties interested shall be justified in assuming:

"(a) If the draft is by its terms or legal effect payable on demand or presentation or at sight, or not more than three days thereafter (whether such three days be termed days of grace or not), that the seller intended to require payment of the draft before the buyer should be entitled to receive or retain the bill.

"(b) If the draft is by its terms payable on time, extending beyond three days after demand, presentation or sight (whether such days be termed days of grace or not), that the seller intended to require acceptance, but not payment of the draft before the buyer should be entitled to receive or retain the bill.

"The provisions of this section are applicable whether by the terms of the bill the goods are consigned to the seller, or to his order, or to the buyer, or to his order, or to a third person, or to his order."

The effect of this UCC modification of the Uniform Bills of Lading Act is to compel a document of title with draft attached to be delivered to the drawee upon his acceptance of the draft if by its terms it is payable more than three days after presentment; if it is payable within three days of presentment, the documents of title shall be delivered only upon payment being made.

In North Carolina where seller of goods shipped them by carrier, with a bill of lading sent with a draft attached for the purchase price, title remained in the seller until the draft was paid. Neither documents of title nor title passed until the draft was paid. See Early & Daniels Co. v. Aulander Flour Mills, 187 N.C. 344, 121 S.E. 539 (1924).

There is a change in North Carolina law by this addition.

§ 25-2-515. Preserving evidence of goods in dispute.

In furtherance of the adjustment of any claim or dispute

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and

(b) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under paragraph (a), to afford either party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor does paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, nonconformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, therefore, until the buyer has made payment, inspected and rejected the goods, there is no occasion or use for the rights under paragraph (a).

3. Under paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity", at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition", at the other end of the scale, includes nothing but the degree of damage or deterioration which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing of this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this Act, for it is a third party document.

Cross References:

Point 2: Sections 2-513(3), 2-706 and 2-711(2) and Article 5.

Point 3: Sections 1-202 and 1-207.

Definitional Cross References:

"Conform". Section 2-106.
"Goods". Section 2-105.
"Notification". Section 1-201.
"Party". Section 1-201.

NORTH CAROLINA COMMENT

There is no counterpart to this section in prior North Carolina law, either statutory or decisional.

PART 6.

BREACH, REPUDIATION AND EXCUSE.

§ 25-2-601. Buyer's rights on improper delivery.

Subject to the provisions of this article on breach in installment contracts (G.S. 25-2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (G.S. 25-2-718 and 25-2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or
(b) accept the whole; or
(c) accept any commercial unit or units and reject the rest. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
No one general equivalent provision but numerous provisions, dealing with situations of non-conformity where buyer may accept or reject, including Sections 11, 44 and 69(1), Uniform Sales Act.

Changes: Partial acceptance in good faith is recognized and the buyer's remedies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

Purposes of Changes: To make it clear that:

1. A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

Cross References:
Sections 2-602(2) (a), 2-612, 2-718 and 2-719.

Definitional Cross References:
"Buyer". Section 2-103.
"Commercial unit". Section 2-105.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Installment contract". Section 2-612.
"Rights". Section 1-201.

NORTH CAROLINA COMMENT

The law in North Carolina was that if the contract for the purchase of goods was *divisible,* a buyer's acceptance of a part of a shipment of goods did not obligate the buyer to receive the remainder of nonconforming goods which did not come up to the contract. See Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904); Freeman v. Skinner, 31 N.C. 32 (1848). In other words, the prior North Carolina law recognized a buyer's right to accept part of a shipment of a divisible contract and reject the balance of shipment if it did not conform to the contract; such partial acceptance of goods did not constitute a waiver of defects as to the quality or quantity of the remainder of the goods.

But see J. W. Sanders Cotton Mill v. Capps, 104 F. Supp. 617 (E.D.N.C. 1952), that where there is a "single order and only one transaction" purchaser may not accept part of a shipment and reject the remainder, but must either affirm or repudiate.

Thus under prior North Carolina law whether a buyer might accept part of the goods contracted for and reject nonconforming goods would appear to have been based on whether the contract was divisible. The UCC section here involved bases the buyer's right of acceptance or rejection on commercial units rather than upon the test of divisibility or indivisibility of the contract of sale. (A commercial unit is a unit of goods by commercial usage whose division impairs its character or value on the market or in use.)

The results of the cases under the prior law and under the UCC will probably be the same with reference to this section. The results should, however, be more predictable than under prior law.

CASE NOTES

Applied in Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); Graybar Elec. Co. v. Shook, 17 N.C. App. 81, 193 S.E.2d 392 (1972); Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975).

Cited in Watson v. Graf Bae Farm, Inc., 99 N.C. App. 210, 392 S.E.2d 651 (1990).

§ 25-2-602. Manner and effect of rightful rejection.

(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (G.S. 25-2-603 and 25-2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this article (subsection (3) of G.S. 25-2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this article on seller's remedies in general (G.S. 25-2-703). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 50, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this Article dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in Section 1-201.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's disposition, this section continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to be appropriately limited or modified when a negotiation is in process.

Cross References:

Point 1: Sections 1-201, 1-204(1) and (3), 2-512(2), 2-513(1) and 2-606(1) (b).

Point 2: Section 2-603(1).

Point 3: Section 2-703.

Definitional Cross References:

"Buyer". Section 2-103.
"Commercial unit". Section 2-105.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Notifies". Section 1-201.
"Reasonable time". Section 1-204.
"Remedy". Section 1-201.
"Rights". Section 1-201.
"Seasonably". Section 1-204.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with the cases of Hajoca Corp. v. Brooks, 249 N.C. 10, 105 S.E.2d 123 (1958); Hendrix v. B & L Motors, Inc., 241 N.C. 644, 86 S.E.2d 448 (1955); Hutchins v. Davis, 230 N.C. 67, 52 S.E.2d 210 (1949); May v. Loomis, 140 N.C. 350, 52 S.E. 728 (1905);

Huyett & Smith Mfg. Co. v. Gray, 124 N.C. 322, 32 S.E. 718 (1899); Waldo v. Halsey, 48 N.C. 107 (1855) and McEntyre v. McEntyre, 34 N.C. 302 (1851). The latter case states: "If one, not having seen them, orders goods of a certain description, at a certain price, and the goods sent do not answer the description, he may return them, within a reasonable time, and rescind the contract . . . ."

Subsection (2) also accords with prior North Carolina law. Huyett & Smith Mfg. Co. v. Gray, 124 N.C. 322, 32 S.E. 718 (1899) states: "The purchaser is not compelled in all cases to reject the property, at once, upon its receipt; if it is machinery, he has a reasonable time to operate the machinery for the purpose of testing it. But when this is done, and it is found that the machine or the machinery does not fill the specifications of the contract and warranty, he must then abandon the contract and refuse to accept and use the property; and if he does not do this, but continues the possession and use of the property, he will be deemed in law to have accepted the property, and his relief then will be an action for damages upon the breach of the warranty." See Nationwide Mut. Ins. Co. v. Don Allen Chevrolet Co., 253 N.C. 243, 116 S.E.2d 780 (1960); Bruton v. Bland, 260 N.C. 429, 132 S.E.2d 910 (1963).

Legal Periodicals. — For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

The Uniform Commercial Code emphasizes promptness and good faith. Graybar Elec. Co. v. Shook, 283 N.C. 213, 195 S.E.2d 514 (1973).

A prospective purchaser may exercise a valid right to reject. Graybar Elec. Co. v. Shook, 283 N.C. 213, 195 S.E.2d 514 (1973).

And even if he takes possession, responsibility expires after a reasonable time in which the owner has opportunity to repossess. Graybar Elec. Co. v. Shook, 283 N.C. 213, 195 S.E.2d 514 (1973).

Acceptance precludes rejection of the goods accepted and, if made with knowledge of a nonconformity, cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

What Constitutes Effective Rejection. — Effective rejection means (1) rejection within a reasonable time after delivery or tender, and (2) seasonable notice to the seller. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Buyer Not Liable for Rejected Goods Which Were Later Stolen. — In an action to recover the sales price of nonconforming cable which was rejected by the buyer and which was stolen from the buyer's storage space three months after the buyer gave notice of rejection, where the buyer did not contract to return the cable and was not negligent in storing it, the trial court properly concluded that the buyer was not liable for the resulting loss. Graybar Elec. Co. v. Shook, 283 N.C. 213, 195 S.E.2d 514 (1973).

Remaining in Mobile Home after Revocation or Rejection. — The fact that plaintiff stayed in a mobile home unit after allegedly revoking or rejecting the unit does not alone necessarily vitiate any of the buyer's rights. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Finding of Revocation or Rejection Warrants Same Relief. — Any error committed by the district court in finding a rejection instead of a revocation of acceptance would be deemed harmless, since evidence warranted a finding of revocation. In either case the plaintiff's relief would be the same. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Recovery upon Revocation or Rejection. — If the buyer makes an effective rejection of a mobile home, or justifiably revokes his acceptance of it, he has a right to recover "so much of the price as had been paid" plus any incidental and consequential damages he is able to prove. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Evidence of Rejection Insufficient. — Buyer's evidence was insufficient to support a finding that she rejected a mobile home where it showed that, after telling seller when the mobile home was installed that "this is not right and I do not want it," buyer moved into the mobile home and made three monthly payments under the terms of the contract. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

The buyer first properly rejected the goods by notifying seller of nonconformities and in the interim, repaired and sold some of the defective goods with the promise that they would be replaced; however buyer excercised ownership by donating the rest of the goods to charity; this ultimately constituted an acceptance. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

Company that ordered telephone equipment accepted the equipment because it did not reject it, pursuant to a contract it signed to purchase the equipment, within three weeks after the equipment was installed, and because the general notice which the company gave that the equipment did not conform to its requirements did not revoke its acceptance, the trial court properly granted summary judgment for a company that sold the equipment on its claim that the company which bought the equipment wrongfully failed to pay for it. Business Communs. v. Ki Networks, 157 N.C. App. 710, 580 S.E.2d 77, 2003 N.C. App. LEXIS 937 (2003).

Applied in Graybar Elec. Co. v. Shook, 17 N.C. App. 81, 193 S.E.2d 392 (1972); Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975).

Cited in Trio Estates, Ltd. v. Dyson, 10 N.C. App. 375, 178 S.E.2d 778 (1971); Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184 (1980); Watson v. Graf Bae Farm, Inc., 99 N.C. App. 210, 392 S.E.2d 651 (1990).

§ 25-2-603. Merchant buyer's duties as to rightfully rejected goods.

(1) Subject to any security interest in the buyer (subsection (3) of G.S. 25-2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent (10%) on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at the market of rejection". A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of Sections 4-503 and 5-112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control", but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practically effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

Cross References:
Point 2: Sections 4-503 and 5-112.
Point 5: Section 1-106. Compare generally Section 2-706.

Definitional Cross References:
"Buyer". Section 2-103.
"Good faith". Section 1-201.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or cases which bear on the subject matter of this section.

CASE NOTES

Continued Use of Rejected Goods. — As a merchant dealing in tables, it was buyer's duty, upon rejection of defective tables, to follow seller's reasonable instructions with respect to the tables; when no instructions were forthcoming, it was proper for merchant to repair and see the goods in the interim, while promising to replace the defective product. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

Cited in Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-604. Buyer's options as to salvage of rightfully rejected goods.

Subject to the provisions of the immediately preceding section [G.S. 25-2-603] on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:
The basic purpose of this section is twofold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1) non-conformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection, and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and nonmerchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

Cross References:
Sections 2-602(1), 2-603(1) and 2-706.

Definitional Cross References:
"Buyer". Section 2-103.

"Notification". Section 1-201.
"Reasonable time". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions relating to this section.

CASE NOTES

Use of Tables Consistent with Rejection. — The buyer's actions constituted acceptance of tables for which it had contracted, where it first properly rejected the defective tables by providing reasonable notice of nonconformities to the seller, and its repair and sale of the tables to a customer as an interim measure was reasonable, but its ultimate disposal of the tables to charity was inconsistent with the seller's ownership. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

Cited in Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-605. Waiver of buyer's objections by failure to particularize.

(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent in the documents. (1965, c. 700, s. 1; 2006-112, s. 36.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable. Subsection (1)(a), following the general policy of this Article which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, subsection (1)(b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent on their face. Where payment is required against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an accep-

tance of the goods or impair any options or remedies of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only what is apparent on the face of the documents.

Cross References:
Point 2: Section 2-508.
Point 4: Sections 2-512(2), 2-606(1) (b) and 2-607(2).

Definitional Cross References:
"Between merchants". Section 2-104.
"Buyer". Section 2-103.
"Seasonably". Section 1-204.
"Seller". Section 2-103.
"Writing" and "written". Section 1-201.

NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions relating to this section.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 36, effective October 1, 2006, substituted "in" for "on the face of" in subsection (2).

§ 25-2-606. What constitutes acceptance of goods.

(1) Acceptance of goods occurs when the buyer
- (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
- (b) fails to make an effective rejection (subsection (1) of G.S. 25-2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
- (c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 48, Uniform Sales Act.

Changes: Rewritten, the qualification in paragraph (c) and subsection (2) being new; otherwise the general policy of the prior legislation is continued.

Purposes of Changes and New Matter: To make it clear that:

1. Under this Article "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he is obligated to do so, and

whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this Article acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material under this Article to the detailed rights and duties of the parties. (See Section 2-401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller's and buyer's remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of paragraph (c) modifies some of the prior case law and makes it clear that "acceptance" in law based on the wrongful act of the acceptor is acceptance only as against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller's ownership under paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under paragraph (a). However, the sections on buyer's rights on improper delivery and on the effect of rightful rejection, make it clear that after he once rejects a tender, paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to Section 2-601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

Cross References:

Point 2: Sections 2-401, 2-509, 2-510, 2-607, 2-608 and Part 7.

Point 4: Sections 2-601 through 2-604.

Point 5: Section 2-601.

Definitional Cross References:

"Buyer". Section 2-103.
"Commercial unit". Section 2-105.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsections (1)(a) and (b) are in accord with Richardson v. Woodruff, 178 N.C. 46, 100 S.E. 173 (1919), which holds that there is no acceptance of goods by the buyer until he has had an opportunity to inspect the goods. Continued use, however, after discovery of nonconformity, or after a reasonable opportunity to discover nonconformity, constitutes an acceptance. Hajoca Corp. v. Brooks, 249 N.C. 10, 105 S.E.2d 123 (1958).

Subsection (1)(c) accords with Ritchie v. Ritchie, 192 N.C. 538, 135 S.E. 458 (1926), which holds that if a buyer sells part of the goods and keeps the proceeds of the sale and applies them to his own use, there is an acceptance. See Hajoca Corp. v. Brooks, 249 N.C. 10, 105 S.E.2d 123 (1958), which holds, however, that retention of goods for the purpose of testing it for a reasonable time or at the request of the seller in order that he may endeavor to remedy the defects does not constitute an acceptance or waiver of the buyer's right to rescind.

Subsection (2) has no statutory or decisional parallel in prior North Carolina law.

CASE NOTES

What Constitutes Acceptance. — Acceptance is ordinarily signified by language or conduct of the buyer that he will take the goods, but this does not necessarily indicate that the goods conform to the contract. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Acceptance may occur by failure of the buyer "to make an effective rejection" after a reasonable opportunity to inspect. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Acceptance in Code terminology is a term of art which is unrelated to the question of passage of title from seller to buyer and is only tangentially related to buyer's possession of goods. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Donation of Goods to Charity Inconsistent with Seller's Ownership. — The buyer first properly rejected the defective goods by notifying seller of nonconformities and in the interim, repaired and sold the goods with the promise they would be replaced; however the buyer ultimately accepted the goods when he donated the rest of the defective to charity. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

What Constitutes Rejection. — Effective rejection means (1) rejection within a reasonable time after delivery or tender, and (2) seasonable notice to the seller. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Revocation of Acceptance. — Acceptance precludes rejection of the goods accepted and, if made with knowledge of a nonconformity, cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

The buyer may revoke his acceptance if (1) the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured, and (2) the nonconformity substantially impairs the value of the goods. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Revocation of acceptance must be made within a reasonable time after the buyer discovers, or should have discovered, the ground for it, and it is not effective until the buyer notifies the seller of it. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Acceptance Entitles Seller to Recover Contract Price and Expenses. — An acceptance of the goods entitles the aggrieved seller to recover the contract price of the goods as well as any expenses reasonably incurred as a result of the breach. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Evidence of Acceptance Sufficient. — Buyer's evidence was sufficient to permit a jury finding that she initially accepted a mobile home on the reasonable assumption that plaintiff would correct the nonconforming defects where it showed that after telling seller when the mobile home was installed that "this is not right and I do not want it," buyer moved into the mobile home and made three monthly payments under the terms of the contract. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Buyer's actions in delivering checks, signing paperwork, and taking delivery of car were so inconsistent with the seller's ownership as to preclude any other interpretation than that she accepted the car. American Imports, Inc. v. G.E. Employees W. Region Fed. Credit Union, 37 N.C. App. 121, 245 S.E.2d 798 (1978).

In an action to recover for breach of contract in the sale of the typesetting equipment, where the record clearly shows that plaintiff retained the machines in question, had possession of them at the time of trial, and had ample time to reject them, particularly since the condition of the goods was fully known to plaintiff, the acts of plaintiff were inconsistent with the seller's (defendant's) ownership and constituted acceptance under subsection (1)(c) of this section. Danjee, Inc. v. Addressograph Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665, cert. denied, 300 N.C. 196, 269 S.E.2d 623 (1980).

Company that ordered telephone equipment accepted the equipment because it did not reject it, pursuant to a contract it signed to purchase the equipment, within three weeks after the equipment was installed, and because the general notice which the company gave that the equipment did not conform to its requirements did not revoke its acceptance, the trial court properly granted summary judgment for a company that sold the equipment on its claim that the company which bought the equipment wrongfully failed to pay for it. Business Communs. v. Ki Networks, 157 N.C. App. 710, 580 S.E.2d 77, 2003 N.C. App. LEXIS 937 (2003).

Denial of Indebtedness by Defendant Raised Issue of Acceptance. — In an action to recover the balance allegedly due on a contract of sale of a machine wherein the defendant admitted that he purchased and received the machine, that he made no payments under the contract except a down payment, and that plaintiff repossessed the machine, defendant's denial of any indebtedness to the plaintiff raised an issue for the jury as to whether defendant accepted the machine within the meaning of this section; if the jury determines that the defendant accepted the machine, it must then determine what amount, if any, plaintiff is entitled to recover from defendant under the terms of the contract. Trio Estates, Ltd. v. Dyson, 10 N.C. App. 375, 178 S.E.2d 778 (1971).

Applied in Ace Chem. Corp. v. Atomic Paint Co., 31 N.C. App. 221, 229 S.E.2d 55 (1976); ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976); Stutts

v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980); Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184 (1980).

§ 25-2-607. Effect of acceptance; notice of breach; burden of establishing breach after acceptance; notice of claim or litigation to person answerable over.

(1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a nonconformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this article for nonconformity.

(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (subsection (3) of G.S. 25-2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of G.S. 25-2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of G.S. 25-2-312). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Section 41, Uniform Sales Act; Subsections (2) and (3) — Sections 49 and 69, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that:

1. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in quantum valebat cases, to be determined in terms of "the contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this Article have been brought to bear.

2. Under subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a non-conformity known to the buyer at the time of acceptance, except where the buyer has accepted on the reasonable assumption that the non-conformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier non-conforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section covering statements of defects upon rejection (Section 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort to a remedy. The notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this Article various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was non-conforming and the buyer has given the seller notice of breach under subsection (3). For subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by way of cross-claim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3) (b) and (5) (b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5) (a) codifies for all warranties the practice of voucher to defend. Compare Section 3-803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under Section 2-312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

Cross References:

Point 1: Section 1-201.
Point 2: Section 2-608.
Point 4: Sections 1-204 and 2-605.
Point 5: Section 2-318.
Point 6: Section 2-717.
Point 7: Sections 2-312 and 3-803.
Point 8: Section 1-207.

Definitional Cross References:

"Burden of establishing". Section 1-201.
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Notifies". Section 1-201.
"Reasonable time". Section 1-204.
"Remedy". Section 1-201.
"Seasonably". Section 1-204.

NORTH CAROLINA COMMENT

Subsection (1) accords with Parker v. Fenwick, 138 N.C. 209, 50 S.E. 627 (1905), which requires payment of price upon acceptance. See also Dodson v. Moore, 64 N.C. 512 (1870).

Subsection (2) accords with Spiers v. Halsted, 74 N.C. 620 (1876), that mere acceptance of a purchased article does not itself constitute a waiver of damages for a delay in performance of the contract. Cox v. Long, 69 N.C. 7 (1873), Thomas v. Simpson, 80 N.C. 4 (1899), and Potter v. National Supply Co., 230 N.C. 1, 51 S.E.2d 908 (1949), hold that a purchaser does not waive his right to sue a seller for damages because of the inferior quality of articles purchased or for breach of warranty by the mere acceptance and retention of goods not fulfilling the terms of the contract.

Subsection (3)(a) accords with Main v. Field, 144 N.C. 307, 56 S.E. 943 (1907), that a buyer of goods has a reasonable time within which to give the seller notice of a breach of warranty after acceptance of the goods.

Subsection (3)(b) has no prior North Carolina statutory or decisional parallel.

Subsection (4) accords with Furst v. Taylor, 204 N.C. 603, 169 S.E. 185 (1933); Parker v. Fenwick, 138 N.C. 209, 50 S.E. 627 (1905).

Subsections (5) and (6) have no prior North Carolina statutory or decisional equivalents.

Legal Periodicals. — For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For discussion of the "reasonable notice" aspect of warranty law, in light of Maybank v. S.S. Kresge, 302 N.C. 129, 273 S.E.2d 681 (1981), see 61 N.C.L. Rev. 177 (1982).

For article on notice of breach in nonprivity contexts, see 66 N.C.L. Rev. 107 (1987).

CASE NOTES

Acceptance Limits Buyer's Remedy to Damages for Breach. — If buyer accepted a mobile home and did not revoke such acceptance, he was obligated to pay the balance due on the contract price and was limited on his counterclaim to recovery of damages for breach of implied warranty of fitness. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Acceptance of goods by the buyer required that the buyer pay the contract price for the goods accepted, retaining, however, the right to counterclaim for breach of warranty by the seller, and the burden of establishing such breach shifted to the buyer. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

But Does Not Bar Action for Breach of Warranty. — While the purchaser of a mobile home was obligated to pay the contract price when she paid the loan on the home and released the lender, thereby accepting the home and barring rejection, she could still maintain an action for breach of warranty. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

A buyer who accepts goods must pay the seller the contract price, but can sue the seller for breach of warranty. Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

What Aggrieved Party Must Show. — Where an aggrieved party seeks to recover damages for breach of an express warranty, limited or otherwise, he must demonstrate both that he has fulfilled his own obligations under it and that he has taken the steps required by this article. Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980).

Covenants to Repair and Replace Defective Parts. — Although limited warranties are valid, compliance with their covenants to repair and to replace defective parts requires that the warrantor do more than make good faith attempts to repair defects when requested to do so, and a manufacturer or other warrantor may be liable for breach of warranty when it repeatedly fails within a reasonable time to correct a defect as promised; moreover, a party seeking to recover for breach of a limited warranty is not required to give the warrantor unlimited opportunities to attempt to bring the item into compliance with the warranty. Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980).

The burden is upon the buyer to establish a breach by the seller of the warranty of merchantability; that is, to show that the defect existed at the time of the sale. Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975).

Policy behind Subsection (3)(a) Notice Requirement. — Perhaps the most important policy behind the notice requirement of this section is enabling the seller to make efforts to cure the breach by making adjustments or replacements in order to minimize the buyer's damages and the seller's liability; however, in cases where the defective goods have caused personal injury, this policy has no application because the damage has already occurred and is irreversible. Maybank v. S.S. Kresge Co., 302 N.C. 129, 273 S.E.2d 681 (1981).

The most important policy behind the notice requirement of this section is to allow the seller the opportunity to cure the breach and minimize its damages. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Notice under Subdivision (3)(a) Condition Precedent to Recovery. — The notice "within a reasonable time" required by subdivision (3)(a) of this section in an action for breach of warranty against the immediate seller is a condition precedent to recovery which must be pled and proved by plaintiff rather than an affirmative defense which must be raised by defendant seller. Maybank v. S.S. Kresge Co., 302 N.C. 129, 273 S.E.2d 681 (1981).

What Constitutes Notice "Within a Reasonable Time". — If a delay in giving the notice required by subdivision (3)(a) operates to deprive the seller of a reasonable opportunity to discover facts which might provide a defense or which might lessen his liability, thus defeating the policy behind the notice requirement, the notice might be said not to have been given within a reasonable time. Maybank v. S.S. Kresge Co., 302 N.C. 129, 273 S.E.2d 681 (1981).

Jury Issue as to Seasonable Notice. — When the plaintiff in an action for breach of warranty is a lay consumer and notification is given to the defendant seller by the filing of an action within the period of the statute of limitations, and when the applicable policies behind the requirement of notice to the seller have been fulfilled, the plaintiff is entitled to go to the jury on the issue of seasonable notice to the seller. Maybank v. S.S. Kresge Co., 302 N.C. 129, 273 S.E.2d 681 (1981).

In an action to recover on the theory of breach of warranty of merchantability for injuries resulting from the explosion of a flashcube sold to plaintiff by defendant, plaintiff's evidence was sufficient to go to the jury on the issue of whether plaintiff gave defendant notice "within a reasonable time", where it tended to show that the filing of the suit and accompanying service upon defendant some three years after the explosion was defendant's first notice that the flashcube was defective and had caused injury, that plaintiff was a lay consumer, and that the flashcube which exploded and the carton in which it was purchased were available as evidence at the trial. Maybank v. S.S. Kresge Co., 302 N.C. 129, 273 S.E.2d 681 (1981).

The question of whether adequate notice of breach was given was one for the jury. Management Sys. Assocs. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985).

Waiver of Defense. — Where defendant does not assert failure to give notice as an affirmative defense, it is deemed waived. Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980), aff'd in part and rev'd in part, 302 N.C. 129, 273 S.E.2d 681 (1981).

Evidence Sufficient to Make Out Case for Seller. — Seller's proof of the sale and delivery of a car at an agreed price and buyer's admission that she took the car, executed the papers connected with the sale and then refused to pay the purchase price makes out a case entitling seller to recover the amount due on the purchase price, nothing else appearing. American Imports, Inc. v. G.E. Employees W. Region Fed. Credit Union, 37 N.C. App. 121, 245 S.E.2d 798 (1978).

Defendant breached its express warranty to plaintiffs when it refused to further repair plaintiffs' car only 10 months after purchase and within the 12 month warranty period. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Security Interest. — Bankruptcy court concluded that the claimant's motion for summary judgment, made pursuant to Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056, should be granted based upon the undisputed facts of record and that the debtor's motion for summary judgment should be denied; the court found that the claimant was entitled to invoke the equitable doctrine of recoupment after the court found that the evidence failed to establish a security interest in the showroom furniture in issue in favor of the claimant, as the claimant asserted pursuant to G.S. 25-2-607 and G.S. 25-2-711. In re Lincoln-Gerard USA, Inc., — Bankr. —, 2002 Bankr. LEXIS 1753 (Bankr. M.D.N.C. July 18, 2002).

Applied in Ace Chem. Corp. v. Atomic Paint Co., 31 N.C. App. 221, 229 S.E.2d 55 (1976); ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976); Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282 (1979); Danjee, Inc. v. Addressograph Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665 (1980).

Cited in Reid v. Eckerds Drugs, Inc., 40 N.C. App. 476, 253 S.E.2d 344 (1979); Southern of Rocky Mount, Inc. v. Woodward Specialty Sales, Inc., 52 N.C. App. 549, 279 S.E.2d 32 (1981); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987); Halprin v. Ford Motor Co., 107 N.C. App. 423, 420 S.E.2d 686 (1992); Bryant v. Adams, 116 N.C. App. 448, 448 S.E.2d 832 (1994); Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

§ 25-2-608. Revocation of acceptance in whole or in part.

(1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 69(1) (d), (3), (4) and (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the non-conformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under paragraph (b) of subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this Article is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reasonable time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of non-conformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this Article, the requirements of the content of notification are less stringent in the case of a nonmerchant buyer.

6. Under subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

Cross References:

Point 3: Section 2-721.
Point 4: Sections 1-204, 2-602 and 2-607.
Point 5: Sections 2-605 and 2-607.
Point 7: Section 2-601.

Definitional Cross References:

"Buyer". Section 2-103.
"Commercial unit". Section 2-105.
"Conform". Section 2-106.
"Goods". Section 2-105.
"Lot". Section 2-106.
"Notifies". Section 1-201.
"Reasonable time". Section 1-204.
"Rights". Section 1-201.

"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1)(a) accords with Hajoca Corp. v. Brooks, 249 N.C. 10, 105 S.E.2d 123 (1958), that a buyer's retention of goods during a period in which seller makes efforts to remedy defects does not bar buyer from thereafter electing to rescind contract.

Subsection (1)(b) accords with Case Threshing Mach. Co. v. McKay, 161 N.C. 584, 77 S.E. 848 (1913), that retention of a machine at seller's request to try to make it perform the service it was represented as capable of performing does not prevent the purchaser from rescinding the purchase. See also Thomas v. Simpson, 80 N.C. 4 (1879), that acceptance of goods in ignorance of defect therein is not a waiver of implied warranty of quality.

Subsection (2) accords with Huyett & Smith Mfg. Co. v. Gray, 124 N.C. 322, 32 S.E. 718 (1899), that a purchaser has reasonable time to operate machinery for the purpose of testing it; if machinery does not come up to contract, he may abandon the contract and refuse to receive and use the property. See also Hendrix v. B & L Motors, Inc., 241 N.C. 644, 86 S.E.2d 448 (1955).

Subsection (3) accords with Hendrix v. B & L Motors, Inc., 241 N.C. 644, 86 S.E.2d 448 (1955), and Curtis v. White Cadillac-Olds, Inc., 248 N.C. 717, 104 S.E.2d 877 (1958).

Legal Periodicals. — For survey of 1972 case law on revocation of acceptance, see 51 N.C.L. Rev. 1170 (1973).

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

Subsection (2) of this statute is for the protection of sellers where the buyer allows the goods to deteriorate, creating the risk that the alleged defect was caused or aggravated by the buyer's action or inaction. Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

Acceptance of goods without discovery of nonconformities must be judged in the light of whether such acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances. Wright v. O'Neal Motors, Inc., 57 N.C. App. 49, 291 S.E.2d 165, cert. denied, 306 N.C. 393, 294 S.E.2d 221 (1982).

Significant nonavailability of goods may relate to the question of substantial impairment of value. Wright v. O'Neal Motors, Inc., 57 N.C. App. 49, 291 S.E.2d 165, cert. denied, 306 N.C. 393, 294 S.E.2d 221 (1982).

Grounds for Revocation. — The buyer may revoke his acceptance if (1) "the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured," and (2) the nonconformity substantially impairs the value of the goods. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

A tender of the goods to the seller is not required in order to revoke acceptance. Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

Subsection (2) of this section does not apply to goods that are defective before a change is made in them by the buyer. Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984).

Issue Is Whether Goods Have Nonconformity Which Substantially Impairs Value to Buyer. — The threshold issue is whether the goods have a nonconformity which substantially impairs their value to the buyer. Resolution of this factual issue requires the application of a two-part test which considers both the buyer's subjective reaction to the alleged defect (taking into account the buyer's needs, circumstances, and reaction to the nonconformity) and the objective reasonableness of this reaction (taking into account the goods' market value, reliability, safety, and usefulness for purposes for which similar goods are used, including efficiency of operation, cost of repair of nonconformities, and the seller's ability or willingness to seasonably cure the nonconformity). Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

What Buyer Must Show. — In order for the buyer to show that his revocation was justifiable, the following four elements must be proved: (1) that the goods contained a nonconformity that substantially impaired their value to him; (2) that he either accepted the goods knowing of the nonconformity but reasonably assuming that it would be cured, or that he accepted the goods not knowing of the nonconformity due to the difficulty of discovery or reasonable assurances from the seller that the goods were conforming; (3) that revocation occurred within a reasonable time after he discovered or should have discovered the defect; and (4) that he has notified the seller of his revocation. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

The proper test for buyer reaction to be applied is a "personalized objective test," or how a reasonable person would react if in the buyer's position. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

Manufacturers of products other than self-propelled motor vehicles who are not in a direct contractual relationship with ultimate purchasers are, by implication, not "sellers" against whom purchasers may revoke acceptance. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Manufacturers of Mobile Homes. — Except in the case of self-propelled vehicles for which the statute expressly provides otherwise, the existence of a direct contractual relationship between buyer and seller is generally a prerequisite to the right of a buyer to revoke acceptance against the seller; therefore, plaintiff mobile home buyers were not entitled to revoke acceptance of the mobile home against defendant manufacturer. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Compliance with Statutory Prerequisites Involves Questions of Fact. — Compliance with each of the statutory prerequisites to revocation involves questions of fact, not matters of law for the trial court. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

What Constitutes Notice to Revoke. — Any conduct clearly manifesting a desire of the buyer to get his money back is a sufficient notice to revoke. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Formal notice that acceptance is being revoked is not necessary; any conduct by the buyer manifesting to the seller that he is seriously dissatisfied with the goods and expects redress or satisfaction is sufficient. Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984).

Plaintiffs never notified defendant of their revocation of acceptance of defective automobile; therefore, plaintiffs were not entitled to damages under G.S. 25-2-711. Instead, plaintiffs were only entitled to damages for breach of warranty as set forth in G.S. 25-2-714. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Tender of goods by the buyer to the seller is not an essential element of a revocation of acceptance. All that is required is a notification of revocation. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Waiver of Right to Rescind. — The purchaser waives his right to rescind if, after discovery of the defect or fraud, he ratifies the sale by continuing to use the chattel for his own purposes. Cooper v. Mason, 14 N.C. App. 472, 188 S.E.2d 653 (1972).

Rescission Treated as Revocation of Acceptance. — Assuming without deciding that rescission remains available to a buyer as a remedy by virtue of § 25-1-103, the Supreme Court gave effect to a buyer's allegation of "rescission" as an allegation of "revocation of acceptance", since that Code concept more nearly reflected the claims asserted by the buyer. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Delay in Revocation to See If Assurances Have Been Met Is Not Per Se Unreasonable. — When the seller has made repeated assurances that the defect can be and will be cured, a delay in revocation to see if these assurances are met and use of the product is not per se unreasonable. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

Reasonable Time Is Question for Jury. — What is a reasonable time for a buyer to revoke his acceptance is ordinarily a question of fact for the jury. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984).

Timeliness of Revocation Is Question of Law When Facts Undisputed. — Although whether the acceptance of a purchase has been timely revoked is usually a question of fact, when the facts are undisputed and only one inference can be drawn from them it is a question of law for the court. Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

The existence of any express or implied warranties would be relevant to show the standard to which the goods were supposed to conform. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979).

All Surrounding Circumstances May Be Considered. — In determining whether revocation was made within a reasonable time after the buyer discovered or should have discovered the nonconformity, it is proper to consider all the surrounding circumstances, including the nature of the defect, the complexity of the goods involved, the sophistication of the buyer, and the difficulty of its discovery. Indeed the reasonable time period may extend in certain cases beyond the time in which notice of the nonconformity has been given, as for example where the parties make attempts at adjustment. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979).

Reasonable Time Exceeded. — Seventeen months and 30,000 miles were held to exceed a reasonable time for revocation of the purchase of an automobile. Cooper v. Mason, 14 N.C. App. 472, 188 S.E.2d 653 (1972).

Remaining in Mobile Home After Revocation or Rejection. — The fact that plaintiff stayed in a mobile home unit after allegedly revoking or rejecting the unit does not alone necessarily vitiate any of the buyer's rights. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Burden Is on Buyer to Show That Revocation Was Justifiable. — When the buyer revokes his acceptance, the burden is on him to show that such revocation was justifiable before he will be allowed to recover. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979).

Facts Sufficient to Justify Revocation. — A crankshaft which was cracked and caused damage to other parts of the engine substantially impaired the crankshaft's value to buyer and his revocation was justifiable. Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

Defects existing in an automobile substantially impaired its value to the plaintiffs so that they were entitled to revoke acceptance. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Facts Insufficient to Justify Revocation. — An automobile buyer had no right under this section to revoke her acceptance of automobile because (1) the odometer was not working when the car was delivered to her or (2) the fan belt broke two days after the delivery, since there was no evidence that the mileage shown on the odometer was not the actual mileage or that she was prevented from discovery of the actual mileage by the seller's assurances, and since the breaking of the fan belt was insufficient to show such nonconformity as would allow her to revoke her acceptance. American Imports, Inc. v. G.E. Employees W. Region Fed. Credit Union, 37 N.C. App. 121, 245 S.E.2d 798 (1978).

Company that ordered telephone equipment accepted the equipment because it did not reject it, pursuant to a contract it signed to purchase the equipment, within three weeks after the equipment was installed, and because the general notice which the company gave that the equipment did not conform to its requirements did not revoke its acceptance, the trial court properly granted summary judgment for a company that sold the equipment on its claim that the company which bought the equipment wrongfully failed to pay for it. Business Communs. v. Ki Networks, 157 N.C. App. 710, 580 S.E.2d 77, 2003 N.C. App. LEXIS 937 (2003).

Mere malfunction does not prove existence of defective material or workmanship. Massey-Ferguson Credit Corp. v. Webber, 841 F.2d 1245 (4th Cir. 1988), aff'd, 885 F.2d 865 (4th Cir. 1989).

Evidence of Revocation Sufficient. — Buyer's evidence was sufficient to permit a jury to find that she revoked her acceptance of a mobile home by reason of seller's failure to correct nonconforming defects where buyer continually complained to seller of the defects from September to December and thereafter ceased making payments under the contract. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Finding of Revocation or Rejection Warrants Same Relief. — Any error committed by the district court in finding a rejection instead of a revocation of acceptance would be deemed harmless, since evidence warranted a finding of revocation. In either case the plaintiff's relief would be the same. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

Buyer Need Not Elect Remedies. — A buyer who revokes his acceptance is not required to elect between revocation of acceptance on the one hand and recovery of damages for breach of implied warranty of fitness on the other; both remedies are then available to him. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972).

Recovery upon Revocation or Rejection. — If the buyer made an effective rejection of a mobile home, or justifiably revoked his acceptance of it, he has a right to recover "so much of the price as had been paid" plus any incidental and consequential damages he is able to prove. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

A buyer who revokes his acceptance has the same rights and duties with regard to the goods involved as if he had rejected them. Cato Equip. Co. v. Mathews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

Applied in Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975); Ace Chem. Corp. v. Atomic Paint Co., 31 N.C. App. 221, 229 S.E.2d 55 (1976); ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976); Danjee, Inc. v. Addressograph

Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665 (1980).

Cited in Wachovia Bank & Trust Co. v. Smith, 24 N.C. App. 133, 210 S.E.2d 212 (1974); Harrington Mfg. Co. v. Logan Tontz Co., 53 N.C. App. 625, 281 S.E.2d 423 (1981); Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986); Morris v. Bailey, 86 N.C. App. 378, 358 S.E.2d 120 (1987).

§ 25-2-609. Right to adequate assurance of performance.

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Sections 53, 54(1) (b), 55 and 63(2), Uniform Sales Act.

Purposes:

1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, Section 63 (2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that "reasonable" grounds and "adequate" assurance as used in subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in Jay Dreher Corporation v. Delco Appliance Corporation, 93 F. 2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in Corn Products Refining Co. v. Fasola, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this Article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity".

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith and observe commercial standards. This Article thus approves the statement of the court in James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc., 32 F. 2d 74, (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the Corn Products

Refining Co. case, which held that in the seller's sole judgment, if for *any* reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the buyer's failure to take the 2% discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this Act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to reestablish the security of expectation, results in a breach only "by repudiation" under subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this Article. Acceleration clauses are treated similarly in the Articles on Commercial Paper and Secured Transactions.

Cross References:

Point 3: Section 1-203.
Point 5: Section 2-611.
Point 6: Sections 1-203 and 1-208 and Articles 3 and 9.

Definitional Cross References:

"Aggrieved party". Section 1-201.
"Between merchants". Section 2-104.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Party". Section 1-201.
"Reasonable time". Section 1-204.
"Rights". Section 1-201.
"Writing". Section 1-201.

NORTH CAROLINA COMMENT

There was no statutory or case law in North Carolina as to security for performance to be applicable in anticipation of nonperformance, repudiation or insecurity on the part of either of the contracting parties. This is entirely new.

§ 25-2-610. Anticipatory repudiation.

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or
(b) resort to any remedy for breach (G.S. 25-2-703 or G.S. 25-2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and
(c) in either case suspend his own performance or proceed in accordance with the provisions of this article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (G.S. 25-2-704). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 63(2) and 65, Uniform Sales Act.

Purposes: To make it clear that:

1. With the problem of insecurity taken care of by the preceding section and with provision being made in this Article as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts — namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see Section 1-203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time with his options under this section, unless he has taken some positive action which in good faith requires notification to the other party before the remedy is pursued.

Cross References:

Point 1: Sections 2-609 and 2-612.
Point 2: Section 2-609.
Point 3: Section 2-612.
Point 4: Section 1-203.

Definitional Cross References:

"Aggrieved party". Section 1-201.
"Contract". Section 1-201.
"Party". Section 1-201.
"Remedy". Section 1-201.

NORTH CAROLINA COMMENT

An anticipatory breach of contracts was apparently actionable in North Carolina before the date fixed by a contract for performance. If one party renounced the contract before the date fixed by contract for performance, the other party might treat the renunciation as a "breach" and sue for his damages at once provided the renunciation covered the entire performance to which the contract bound the promisor. See Pappas v. Crist, 223 N.C. 265, 25 S.E.2d 850 (1943); Tillis v. Calvine Cotton Mills, 251 N.C. 359, 111 S.E.2d 606 (1959). In North Carolina, however, for the breach of an executory contract the plaintiff might recover only such substantial damages as could be ascertained and measured with reasonable certainty. While absolute certainty was not required, evidence of damages had to be sufficiently specific and complete to permit the jury to arrive at a reasonable conclusion. A witness was not permitted to give a mere guess or opinion, unsupported by facts, as to the amount of damages arising upon a breach of contract. See Tillis v. Calvine Cotton Mills, 251 N.C. 359, 111 S.E.2d 606 (1959). In addition, the contractor against whom the contract was breached was normally under an obligation to exercise reasonable diligence to minimize the damages caused to him by the breach. Tillis v. Calvine Cotton Mills, 251 N.C. 359, 111 S.E.2d 606 (1959). The result was that in North Carolina, notwithstanding statements of the court that anticipatory breaches of contract were actionable, the court did not favor such actions. In most cases, due to the requirements of certainty and mitigation of damages by the party against whom the contract had been breached, for practical purposes, damages could not be adequately measured prior to the date when the contract by its terms should have been performed. Compare: McJunkin Corp. v. North Carolina Natural Gas Corp., 300 F.2d 794 (4th Cir. 1961); Tillis v. Calvine Cotton Mills, 251 N.C. 359, 111 S.E.2d 606 (1959).

The UCC, GS 25-2-610, provides for immediate relief for an aggrieved party upon a repudiation of the contract by the other party by an overt communication of intention or action which renders performance of the contract impossible or demonstrates clearly an intention not to continue with the performance. It gives the aggrieved party (a) the right to wait a commercially reasonable time for performance by the repudiating party; (b) the right to resort to any remedy set out in GS 25-2-703 (if the seller) and GS 25-2-711 (if the buyer) for breach; or (c) the right to suspend his own performance. (Subsection (c) accords with prior North Carolina law on this point. See Wade v. Lutterloh, 196 N.C. 116, 144 S.E. 694 (1928), that renunciation by one party to contract excuses other from any further offer to perform.)

While North Carolina recognized the doctrine of anticipatory breach of contracts, the limits of the doctrine, especially as to damages recoverable, were uncertain. The UCC not only gives either aggrieved party the right to sue as for breach or to suspend performance in case of repudiation of a contract, but it also establishes the date for the determination of damages. (The date of the anticipatory repudiation of the contract.)

Under the Restatement, Contracts G.S. 338 (1932), and in most states recognizing the doctrine of anticipatory breach in connection with sales, the measure of damages recoverable was the difference between the price as specified in the contract and the market price at the date and place when delivery or performance was to have been made. This formula is complicated as it is often well nigh impossible to determine the price of goods at a future date, especially when the duty to mitigate damages is considered which might very well result in no damages at all.

This section of the UCC and GS 25-2-723 make damages less speculative, providing that if the action comes to trial by reason of anticipatory breach before the date of performance specified in the contract, the damages shall be the difference between the contract price specified and the market price as of "the time the aggrieved party learned of the repudiation." This apparently changes the law of North Carolina. See McJunkin Corp. v. North Carolina Natural Gas Corp., 300 F.2d 794 (4th Cir. 1961), which held that damages for anticipatory breach of contract were to be assessed on the basis of profit factors existent at the time of performance fixed by contract, and not at the time of repudiation.

Legal Periodicals. — For note discussing the measure of buyer's damages upon anticipatory repudiation, see 56 N.C.L. Rev. 370 (1978).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Applied in Superior Foods, Inc. v. Harris-Teeter Super Mkts., Inc., 288 N.C. 213, 217 S.E.2d 566 (1975).

§ 25-2-611. Retraction of anticipatory repudiation.

(1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this article (G.S. 25-2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to warrant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

Cross Reference:
Point 2: Section 2-609.

Definitional Cross References:
"Aggrieved party". Section 1-201.
"Cancellation". Section 2-106.
"Contract". Section 1-201.
"Party". Section 1-201.
"Rights". Section 1-201.

NORTH CAROLINA COMMENT

There is no prior case or statutory law in connection with this section.

§ 25-2-612. "Installment contract"; breach.

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 45(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that:

1. The definition of an installment contract is phrased more broadly in this Article so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this Article applies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This Article also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contract between wholly "entire" and wholly "divisible" contracts has any standing under this Article.

3. This Article rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect.

Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes", a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any uncommercial and legalistic interpretation.

4. One of the requirements for rejection under subsection (2) is non-conformity substantially impairing the value of the installment in question. However, an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under subsection (2) an installment delivery must be accepted if the non-conformity is curable and the seller gives adequate assurance of cure. Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This Article requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation. Adequate assurance for purposes of subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right of cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this Article, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under subsection (3), a buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standards under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross References:

Point 2: Sections 2-307 and 2-607.
Point 3: Section 1-203.
Point 5: Sections 2-208 and 2-609.
Point 6: Section 2-610.

Definitional Cross References:

"Action". Section 1-201.
"Aggrieved party". Section 1-201.
"Buyer". Section 2-103.
"Cancellation". Section 2-106.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Lot". Section 2-105.
"Notifies". Section 1-201.
"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

In accord with LaVallette v. Booth, 131 N.C. 36, 42 S.E. 446 (1902), that buyer may reject installment which is nonconforming or may reject further performance if nonconformity *substantially* impairs whole contract. But compare Statesville Flour Mills Co. v. Wayne Distrib. Co., 171 N.C. 708, 88 S.E. 771 (1916), that breach of a *minor* and *subsidiary* covenant may give rise to an action for damages, but it cannot operate as a discharge.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Defects in Prior Installment are Cumulative in Effect. — The trial court should not have considered the ease of remedying defects of future installments of a contract to purchase custom tables when determining whether past installments substantially impaired the contract as a whole, so as to justify cancellation of a future installment of the contract. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

Cancellation of Entire Contract Proper. — Nonconformities in the first two installments of a contract to supply custom tables substantially impaired the contract as a whole, where the tables were impossible to assemble, were delivered late, and were not usable as delivered; furthermore, the seller offered no cure of the defects, and the buyer bore the expense of repairing the tables to meet a deadline known to both parties. Design Plus Store Fixtures, Inc. v. Citro Corp., 131 N.C. App. 581, 508 S.E.2d 825 (1998).

Cited in Rental Towel & Uniform Serv. v. Bynum Int'l, Inc., 304 N.C. 174, 282 S.E.2d 426 (1981).

§ 25-2-613. Casualty to identified goods.

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (G.S. 25-2-324) then

(a) if the loss is total the contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 7 and 8, Uniform Sales Act.

Changes: Rewritten, the basic policy being continued but the test of a "divisible" or "indivisible" sale or contract being abandoned in favor of adjustment in business terms.

Purposes of Changes:

1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved from his obligation but may at his option take the surviving goods at a fair adjustment. "Fault" is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement, including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section

are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term "no arrival, no sale" makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

Cross Reference:
Point 3: Section 2-324.

Definitional Cross References:
"Buyer". Section 2-103.
"Conform". Section 2-106.
"Contract". Section 1-201.
"Fault". Section 1-201.
"Goods". Section 2-105.
"Party". Section 1-201.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

There is neither prior statutory nor case law in North Carolina exactly in point with this section. But compare Stagg v. Spray Water Power & Land Co., 171 N.C. 583, 89 S.E. 47 (1916). See North Carolina Comment to GS 25-2-615.

§ 25-2-614. Substituted performance.

(1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:

1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable. Under this Article, in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between Section 2-613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or non-occurrence of a contingency which was a basic assumption of the contract makes the expected performance impossible. The distinction between the present section and those sections lies in whether the failure or impossibility of performance arises in connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of International Paper Co. v. Rockefeller, 161 App. Div. 180, 146 N.Y.S. 371 (1914) and Meyer v. Sullivan, 40 Cal. App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this Article, of course, the seller would also be entitled, had the market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article 5, especially Sections 5-102, 5-103, 5-109, 5-110 and 5-114.

3. Under subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

Cross Reference:

Point 2: Article 5.

Definitional Cross References:

"Buyer". Section 2-103.
"Fault". Section 1-201.
"Party". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

There is no prior statutory or case law equivalent in North Carolina.

This section seems to accord, however, with the reasoning behind G. Ober & Son v. Smith, 78 N.C. 313 (1878), that when a purchaser designates no particular route or carrier by which goods are to be shipped, it is the duty of the seller to ship the goods in a reasonable course of transit.

Legal Periodicals. — For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

§ 25-2-615. Excuse by failure of presupposed conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section [G.S. 25-2-614] on substituted performance:

(a) Delay in delivery or nondelivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or nondelivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section excuses a seller from timely

delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article, must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this Article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See Ford & Sons, Ltd. v. Henry Leetham & Sons, Ltd., 21 Com. Cas. 55 (1915, K.B.D.).)

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See Davis Co. v. Hoffmann-LaRoche Chemical Works, 178 App. Div. 855, 166 N.Y.S. 179 (1917) and International Paper Co. v. Rockefeller, 161 App. Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See Canadian Industrial Alcohol Co., Ltd., v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and Washington Mfg. Co. v. Midland Lumber Co., 113 Wash. 593, 194 P. 777 (1921).)

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the defaulting supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this Article provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See Madeirense Do Brasil, S. A. v. Stulman-Emrick Lumber Co., 147 F.2d 399 (C.C.A., 2 Cir., 1945).) The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is given by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement sub-contract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it truly "supervenes" in such a manner as to be beyond the seller's assumption of risk. And any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

Cross References:

Point 1: Sections 2-613 and 2-614.
Point 2: Section 1-102.
Point 5: Sections 1-203 and 2-613.
Point 6: Sections 1-102, 1-203 and 2-609.
Point 7: Section 2-614.
Point 8: Sections 1-201, 2-302 and 2-616.
Point 9: Sections 1-102, 2-306 and 2-613.

Definitional Cross References:

"Between merchants". Section 2-104.
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Good faith". Section 1-201.
"Merchant". Section 2-104.
"Notifies". Section 1-201.
"Seasonably". Section 1-204.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (a) seems to accord with prior North Carolina contracts principles that if a party by contract charges himself with an obligation possible to be performed, he must make it good, unless its performance be rendered impossible by an act of God, the law, or the other party, and unforeseen difficulties will not excuse him. However, if the parties contract with reference to specific property, the continued existence of which is clearly contemplated by the obligations assumed, the parties are relieved from further obligations concerning property when it is accidentally lost or destroyed by fire or otherwise, rendering performance of the contract impossible. But in order for a party to avail himself of such position, he must show that the destruction of the specific thing was without his fault. See Stagg v. Spray Water Power & Land Co., 171 N.C. 583, 89 S.E. 47 (1916); Sale v. State Highway & Pub. Works Comm'n, 242 N.C. 612, 89 S.E.2d 290 (1955); Blount-Midyette & Co. v. Aeroglide Corp., 254 N.C. 484, 119 S.E.2d 225 (1961). This is also the rule set out in Taylor v. Caldwell, 3 Best & S. 826 (1863), a widely followed English case.

Subsection (b) is entirely new. There is no statutory or decisional parallel to this subsection in prior North Carolina law which allows seller to make prorata distribution to customers in the event of partial impossibility of performance. Compare Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904).

Subsection (c) has no prior North Carolina statutory or decisional parallel. New.

Legal Periodicals. — For article discussing judicial reallocation of contractual risks under this section, see 54 N.C.L. Rev. 545 (1976).

For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

A seller of goods may limit its liability by inclusion of a single source clause. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

Burden of Loss on Seller. — Failure to make express provision for a foreseeable contingency in a sales contract implicitly places the burden of loss on the seller when the contingency comes to fruition. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

Risk of Governmental Regulation. — Generally, governmental regulations do not excuse performance under a contract where a party has assumed the risk of such regulation. Thus, defendant, by terms of the parties' agreement, accepted responsibility for keeping abreast of governmental regulations bearing upon the contract. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

§ 25-2-616. Procedure on notice claiming excuse.

(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section [G.S. 25-2-615] he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this article relating to breach of installment contracts (G.S. 25-2-612), then also as to the whole,

(a) terminate and thereby discharge any unexecuted portion of the contract; or

(b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under the preceding section [G.S. 25-2-615]. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under subsection (2) his silence after receiving the seller's claim of excuse operates as such a termination. Subsection (3) denies effect to any contract clause made in advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

Cross References:

Point 1: Sections 2-209 and 2-615.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Installment contract". Section 2-612.
"Notification". Section 1-201.
"Reasonable time". Section 1-204.
"Seller". Section 2-103.
"Termination". Section 2-106.
"Written". Section 1-201.

NORTH CAROLINA COMMENT

The procedures established by this section implement the rules established under GS 25-2-614 and 25-2-615. There is no comparable prior statute or case law in North Carolina.

PART 7.

REMEDIES.

§ 25-2-701. Remedies for breach of collateral contracts not impaired.

Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this article. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this Article; but contractual arrangements which as a business matter enter vitally into the contract should be considered a part thereof insofar as cross-claims or defenses are concerned.

Definitional Cross References:

"Contract for sale". Section 2-106.
"Remedy". Section 1-201.

NORTH CAROLINA COMMENT

This section appears to limit the scope of the sales article to parts of a contract related to the sale of goods and would seem to require no comment.

§ 25-2-702. Seller's remedies on discovery of buyer's insolvency.

(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this article (G.S. 25-2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this article (G.S. 25-2-403). Successful reclamation of goods excludes all other remedies with respect to them. (1965, c. 700, s. 1; 1967, c. 562, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Sections 53(1) (b), 54(1) (c) and 57, Uniform Sales Act; Subsection (2) — none; Subsection (3) — Section 76(3), Uniform Sales Act.

Changes: Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.

Purposes of Changes and New Matter: To make it clear that:

1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.

2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Subsection (3) subjects the right of reclamation to certain rights of third parties "under this Article (Section 2-403)." The rights so given priority of course include the rights given to purchasers from the buyer by Section 2-403(1) and (2). They also include other rights arising under Article 2, such as the rights of lien creditors of the buyer under Section 2-326(3) on consignment sales. Moreover, since Section 2-403(4) incorporates by reference rights given to other purchasers and to lien creditors by Articles 6, 7 and 9, such rights have the same priority. "Lien creditor" here has the same meaning as in Section 9-301(3). Thus if a seller retains an unperfected security interest, subordinate under Section 9-301(1) (b) to the rights of a levying creditor of the buyer, his right of reclamation under this section is also subject to the creditor's rights. Purchasers or lien creditors may also have rights not arising under this Article; under Section 1-103 such rights may have priority by virtue of supplementary principles not displaced by this section. See In re Kravitz, 278 F.2d 820 (3d Cir. 1960).

Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all his other remedies as to the goods involved.

Cross References:

Point 1: Sections 2-401 and 2-705.

Compare Section 2-502.

Definitional Cross References:

"Buyer". Section 2-103.

"Buyer in ordinary course of business". Section 1-201.

"Contract". Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 2-105.

"Insolvent". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.
"Receipt" of goods. Section 2-103.
"Remedy". Section 1-201.
"Rights". Section 1-201.
"Seller". Section 2-103.
"Writing". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1) accords with principle applicable in right of stoppage in transitu given to seller who learns of buyer's insolvency before goods are delivered to buyer based on "the plain reason of justice and equity, that one man's goods shall not be applied to the payment of another man's debts." See Farrell v. Richmond & D.R.R., 102 N.C. 390, 9 S.E. 302 (1889).

Subsection (2), which gives a right to the seller to assert a lien on undelivered goods already delivered, is new and changes North Carolina law. If the goods were delivered to the buyer or the carrier had agreed to hold the goods for the buyer, the seller's right of stoppage in transitu, under prior North Carolina law, was lost. See Williams v. Hodges, 113 N.C. 36, 18 S.E. 83 (1893). It was also the law in North Carolina that a vendor of personal property had no lien for the purchase money. See Bafarrah v. Spell, 178 N.C. 231, 100 S.E. 321 (1919). An insolvent buyer did not have to disclose his insolvency. If, however, the insolvent buyer misrepresented his solvency and thereafter went into bankruptcy, even under prior North Carolina law, the seller could recover the property. On a sale of goods, induced by fraud on the part of the vendee, the vendor was authorized to reclaim the property, and the title thereto revested in him. See Wilson v. White, 80 N.C. 280 (1878).

Change: While insolvency of buyer alone did not allow a seller to reclaim goods under prior law (requiring a misrepresentation that equaled fraud), this section allows the buyer to reclaim, even after delivery, from a buyer who received goods while insolvent. It extends the theory behind stoppage in transitu. Subsection (3) protects purchasers in ordinary course of business, purchasers for value and lien creditors of buyer.

Legal Periodicals. — For discussion of the constructive trust as a remedy for the seller, see 45 N.C.L. Rev. 424 (1967).

For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

CASE NOTES

The holder of a perfected security interest in after acquired property qualifies as a "good faith purchaser." First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

The holder of a perfected security interest in after acquired property was a "good faith purchaser" whose rights were superior to a seller of the after acquired goods under subsection (2), several commentators have concluded. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1977).

Priority of Floating Lien over Rights of Reclaiming Sellers. — A floating lien on inventory, assuming the lienholder is a "good faith purchaser," has priority over the rights of reclaiming sellers. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

The rights of a reclaiming seller under this section have a lower status than those of a junior lien creditor, and consequently a reclaiming seller's rights have no value if the floating lien, to which those rights are inferior, exceeds the value of the lienholder's collateral. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

In bankruptcy proceedings, reclaiming sellers are not automatically entitled to an administrative priority or substitute lien if their reclamation rights are frustrated by the presence of a prior lien. The right to an administrative priority or substitute lien exists only if there also exists a right to reclaim. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

But rights of reclaiming sellers are not automatically extinguished simply because those rights may be subject to the rights of a secured creditor. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

Buyer with Voidable Title Can Transfer Better Title Than He Had. — While the buyer might have had a voidable title, if he had made fraudulent representations of solvency, one with voidable title can transfer better title than he had. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

Determination of Misrepresentation of Solvency Unnecessary. — A determination of whether written proposals of exchange made by the buyer to the various sellers was a misrepresentation of solvency was not necessary where, even if the conditions to bring sellers within subsection (2) were present, it was clear that the rights of third parties have intervened to cut off their right to reclaim the property. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

Remedy of Reclamation Is Exception to Rule. — Normally, after the seller has delivered the goods to an accepting buyer, the remedy is an action for the price, and it is too late to retrieve the goods. The remedy of reclamation provided by subsection (2) is an exception to this rule. First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

§ 25-2-703. Seller's remedies in general.

Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (G.S. 25-2-612), then also with respect to the whole undelivered balance, the aggrieved seller may

(a) withhold delivery of such goods;
(b) stop delivery by any bailee as hereafter provided (G.S. 25-2-705);
(c) proceed under the next section [G.S. 25-2-704] respecting goods still unidentified to the contract;
(d) resell and recover damages as hereafter provided (G.S. 25-2-706);
(e) recover damages for nonacceptance (G.S. 25-2-708) or in a proper case the price (G.S. 25-2-709);
(f) cancel. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: No comparable index section.

Purposes:

1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in installment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the non-acceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References:

Point 2: Section 2-612.
Point 3: Section 2-325.
Point 4: Section 1-106.

Definitional Cross References:

"Aggrieved party". Section 1-201.
"Buyer". Section 2-103.
"Cancellation". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Remedy". Section 1-201.
"Seller". Section 2-103.

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

The seller's remedies under this section are cumulative, are to be liberally administered, and depend entirely upon the facts of the individual case. Southern Utils., Inc. v. Jerry Mandel Mach. Corp., 71 N.C. App. 188, 321 S.E.2d 508 (1984), cert. denied, 313 N.C. 510, 329 S.E.2d 395 (1985).

§ 25-2-704. Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods.

(1) An aggrieved seller under the preceding section [G.S. 25-2-703] may

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner. (1965, c. 700, s. 1; 1967, c. 24, s. 9.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
Sections 63(3) and 64(4), Uniform Sales Act.

Changes: Rewritten, the seller's rights being broadened.

Purposes of Changes:

1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regardless of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this Article the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

Cross References:
Sections 2-703 and 2-706.

Definitional Cross References:
"Aggrieved party". Section 1-201.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsections (1)(a) and (b) allow an aggrieved seller to identify any conforming goods under his control to the contract and to resell the goods intended for particular contract even though unfinished. It was doubtful under prior law whether goods not previously identified or segregated to the contract could, after a repudiation by the buyer, be identified or segregated to lay foundation for a resale for the account of the buyer.

Subsection (2) permits the seller to complete goods in manufacture where the completion is commercially reasonable and to resell them so as to fix the damages payable by the buyer where, in a contract calling for the manufacture of goods, the buyer has breached the contract. This subsection apparently changes prior North Carolina law, which in such instances required the seller-manufacturer to stop manufacture and sue only for the labor expended and expense incurred in the past performance before repudiation, plus the profit that would have accrued had full performance not been prevented by the buyer. See Novelty Advertising Co. v. Farmer's Mut. Tobacco Warehouse, 186 N.C. 197, 119 S.E. 196 (1923); Heiser v. Mears, 120 N.C. 443, 27 S.E. 117 (1897).

The principal thrust of this UCC provision is that when a contract is repudiated while goods are in an incomplete state in the process of manufacture, the seller-manufacturer should be permitted to act in good faith in determining by reasonable commercial standards whether to complete manufacture of the goods in process, after buyer's repudiation.

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

§ 25-2-705. Seller's stoppage of delivery in transit or otherwise.

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (G.S. 25-2-702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until

(a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) such acknowledgment to the buyer by a carrier by reshipment or as a warehouse; or

(d) negotiation to the buyer of any negotiable document of title covering the goods.

(3)(a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of possession or control of the document.

(d) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor. (1965, c. 700, s. 1; 2006-112, s. 37.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 57-59, Uniform Sales Act; see also Sections 12, 14 and 42, Uniform Bills of Lading Act and Sections 9, 11 and 49, Uniform Warehouse Receipts Act.

Changes: This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

Purposes: To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case to carriers, and might be a very heavy burden to them if it covered all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger shipments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjustified order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the Documents of Title Article (Section 7-303). Subsection 3(b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the sub-purchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this Article that the seller, by making such direct shipment to the sub-purchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under subsection (3)(b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under subsection (2)(c) when it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the name of the consignee to that of the buyer's local agent but do not alter the destination of a reshipment.

Acknowledgment by the carrier as a "warehouseman" within the meaning of this Article requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouseman.

4. Subsection (3)(c) makes the bailee's obedience of a notification to stop conditional upon the surrender of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

Cross References:

Sections 2-702 and 2-703.

Point 1: Sections 2-503 and 2-609, and Article 7.

Point 2: Section 2-103 and Article 7.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Document of title". Section 1-201.
"Goods". Section 2-105.
"Insolvent". Section 1-201.
"Notification". Section 1-201.
"Receipt" of goods. Section 2-103.
"Rights". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

North Carolina has recognized stoppage in transitu by a seller in the event of a buyer's insolvency. Farrell v. Richmond & D.R.R., 102 N.C. 390, 9 S.E. 302 (1889). If they reached their terminals, however, and were thereafter held by the carrier in storage and the carrier acknowledged to the buyer that it holds the goods for the buyer, the vendor's right to stoppage in transitu was terminated. See Williams v. Hodges, 113 N.C. 36, 18 S.E. 83 (1893).

Neither of these principles seems to be affected by this UCC section. However, it should be noted that under this UCC section, the right of stoppage in transitu is broadened. Stoppage in transitu is available not only when the buyer is insolvent but also upon repudiation by buyer, when a payment is missed, or in any other case the seller has a right to withhold or reclaim the goods.

There are no prior statutes or decisions in North Carolina concerning the further details and procedures relating to stoppages in transit set out in this section of the UCC.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 37, effective October 1, 2006, substituted "a warehouse" for "warehouseman" in subdivision (2)(c); and inserted "of possession or control" in subdivision (3)(c).

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

§ 25-2-706. Seller's resale including contract for resale.

(1) Under the conditions stated in G.S. 25-2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this article (G.S. 25-2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (G.S. 25-2-707) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of G.S. 25-2-711). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 60, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To simplify the prior statutory provision and to make it clear that:

1. The only condition precedent to the seller's right of resale under subsection (1) is a breach by the buyer within the section on the seller's remedies in general or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708.

Under this Article the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in subsection (1). Evidence of market or current prices at any particular time or place is relevant only on the question of whether the seller acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller had resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This Article rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in making the resale to depart from the terms and conditions of the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification or a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4)(b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i. e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to attend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of subsection (4) qualifies the last sentence of subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind.

The provisions of paragraph (c) of subsection (4) are intended to permit intelligent bidding.

The provision of paragraph (d) of subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This Article departs in subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this Article divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of subsection (6).

Cross References:

Point 1: Sections 2-610, 2-702 and 2-703.
Point 2: Section 1-201.
Point 3: Sections 2-708 and 2-710.
Point 4: Section 2-328.
Point 8: Section 2-104.
Point 9: Section 2-710.
Point 11: Sections 2-401, 2-707 and 2-711(3).

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Good faith". Section 2-103.
"Goods". Section 2-105.
"Merchant". Section 2-104.
"Notification". Section 1-201.
"Person in position of seller". Section 2-707.
"Purchase". Section 1-201.
"Rights". Section 1-201.
"Sale". Section 2-106.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law that where a vendee refuses to receive goods, his vendor may resell the goods and hold the original vendee liable for any difference in prices in the first and second sale. See Hurlburt v. Simpson, 25 N.C. 233 (1842). The seller in such cases is also entitled to recover for incidental costs of storage, interest and an allowance for time spent acting as buyer's agent in reselling the goods. See Vanstory Clothing Co. v. Stadiem, 149 N.C. 6, 62 S.E. 778 (1908). See Merrill v. Tew, 183 N.C. 172, 110 S.E. 850 (1922), which indicates that in North Carolina the vendor needed only to exercise reasonable care, skill, and prudence in effecting a resale when the buyer had breached his contract to receive the goods contracted for. This section of the UCC accords generally with North Carolina law which previously allowed the seller to resell upon a buyer's breach, such sale to be in accordance with reasonable commercial practices so as to realize the best price practicable under the circumstances and so as to fix damages.

The remaining subsections allow both private and public sales and set out details of notice and requirements if public sale is held.

The section of the UCC is new to this extent.

Subsection (6) may conflict with prior North Carolina law in that it provides that a seller making a resale need not account to the buyer for any profit made on resale. Under prior law if the seller resold, it was for the account of the buyer as agent if title had passed with the making of the contract. It would seem that in North Carolina under the prior law the buyer as titleholder was entitled to any profits made on resale. He was, of course, under prior law liable for any deficiency. See Vanstory Clothing Co. v. Stadiem, 149 N.C. 6, 62 S.E. 778 (1908). This subsection illustrates the basic rejection by the UCC of the necessity of determining the location of title at any given time.

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Cited in Equitable Leasing Corp. v. Myers, 46 N.C. App. 162, 265 S.E.2d 240 (1980); Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985); Tom Togs, Inc. v. Ben Elias Indus. Corp., 318 N.C. 361, 348 S.E.2d 782 (1986); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-707. "Person in the position of a seller."

(1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this article withhold or stop delivery (G.S. 25-2-705) and resell (G.S. 25-2-706) and recover incidental damages (G.S. 25-2-710). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 52(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for the seller has been included in the term "a person in the position of a seller."

Cross Reference:

Article 5, Section 2-506.

Definitional Cross References:

"Consignee". Section 7-102.
"Consignor". Section 7-102.
"Goods". Section 2-105.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section is designed primarily to allow a financing agency which has acquired documents from the seller to exercise the same rights as the seller in stopping the goods in transit and reselling the goods upon repudiation and recovering incidental damages. There is no prior North Carolina parallel, either statutory or decisional.

§ 25-2-708. Seller's damages for nonacceptance or repudiation.

(1) Subject to subsection (2) and to the provisions of this article with respect to proof of market price (G.S. 25-2-723), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this article (G.S. 25-2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this article (G.S. 25-2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 64, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for non-acceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.

3. In all cases the seller may recover incidental damages.

Cross References:

Point 1: Sections 2-319 through 2-324, 2-503, 2-723 and 2-724.

Point 2: Section 2-709.

Point 3: Section 2-710.

Definitional Cross References:

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina cases in allowing the seller to recover the difference between the contract price and the market price at the time and place of the breach. See Cherry v. Upton Co., 180 N.C. 1, 103 S.E. 912 (1920); Bryant v. Southern Box & Lumber Co., 192 N.C. 607, 135 S.E. 531 (1926); Heise v. Mears, 120 N.C. 443, 27 S.E. 117 (1897).

Subsection (2) also accords with prior North Carolina law where there is a breach of contract and the rule announced in subsection (1) is inadequate (e.g., if the goods are to be manufactured and the buyer repudiates before they are manufactured or before they have value). This subsection, as in prior North Carolina law, allows the seller to recover any profit he would make by full performance after deducting the sum that it would have cost the seller to fully perform. See Bryant v. Southern Box & Lumber Co., 192 N.C. 607, 135 S.E. 531 (1926); Cleveland-Canton Springs Co. v. Goldsboro Buggy

Co., 148 N.C. 533, 62 S.E. 637 (1908).

Incidental damages were recoverable in North Carolina by seller upon buyer's breach. See Vanstory Clothing Co. v. Stadiem, 149 N.C. 6, 62 S.E. 778 (1908), where storage changed before resale was approved; Cole & Sons v. Standard Lumber Co., 150 N.C. 183, 63 S.E. 736 (1909).

This section does not materially change prior North Carolina law.

(Another example of when subsection (1) would not allow recovery of adequate damages would be a situation where dealer is in business having and selling an unlimited supply of standard priced goods. If a dealer sold a car to buyer, for instance, for $2,000 list price, and buyer repudiated, under subsection (1) if the seller kept the car he could not recover from the buyer because the contract price and the value of the car would be the same. Resale will not prove adequate as, by reselling, the seller just makes one sale, whereas, if the buyer had not repudiated, seller could have made two sales. Subsection (2) cures this defect by allowing the seller to recover the profit on the repudiated sale that he would have obtained had no repudiation occurred.)

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Applied in Industrial Circuits Co. v. Terminal Communications, Inc., 26 N.C. App. 536, 216 S.E.2d 919 (1975); Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987).

§ 25-2-709. Action for the price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section [G.S. 25-2-710], the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (G.S. 25-2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceding section [G.S. 25-2-708]. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 63, Uniform Sales Act.

Changes: Rewritten, important commercially needed changes being incorporated.

Purposes of Changes: To make it clear that:

1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has

accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under subsection (1)(b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the advance, a security interest in the goods, the buyer on making the advance has such an interest as soon as the seller has rights in the agreed collateral. See Section 9-204.

5. "Goods accepted" by the buyer under subsection (1) (a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under subsection (1)(b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for non-acceptance. In such a situation, subsection (3) permits a recovery of those damages in the same action.

Cross References:

Point 4: Section 1-106.

Point 5: Sections 2-501, 2-509, 2-510 and 2-704.

Point 7: Section 2-708.

Definitional Cross References:

"Action". Section 1-201.
"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

In North Carolina an action for price could not be maintained unless title had passed to the vendee. Waldo v. Belcher, 33 N.C. 609 (1850); Hendricks v. Mocksville Furniture Co., 156 N.C. 569, 72 S.E. 592 (1911). This is the common-law rule. See Williston G.S. 560 (a) and 561.

The UCC in this section specifies on an enumerated basis the instances in which an action for price can be maintained. Location of title is no longer determinative under the Code, which makes it necessary only to determine if one of the enumerated situations has occurred.

Another important matter is a change of emphasis. An action for "price" seems to be rendered secondary to "efforts to resell." Under prior North Carolina law, a seller upon a breach had an option (1) to treat goods as property of buyer and sue for price or (2) to treat the goods as property of the buyer and resell for him and sue for the difference between the contract price and what the goods have brought upon resale. Vanstory Clothing Co. v. Stadiem, 149 N.C. 6, 62 S.E. 778 (1908). Under this section of the UCC (subsection (1)(b)), the seller may recover the price only after he is unable to resell them after a reasonable effort. It seems that the Code makes it obligatory to attempt resale whereas heretofore it has been held optional with the seller in North Carolina.

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

CASE NOTES

Seller May Recover Contract Price and Reasonable Expenses. — An acceptance of the goods entitles the aggrieved seller to recover the contract price of the goods as well as any expenses reasonably incurred as a result of the breach. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

A buyer who accepts goods must pay the seller the contract price, but can sue the seller for breach of warranty. Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

What Seller Must Prove. — In an action under subsection (1) of this section for the price of goods sold, the seller must carry the burden of proof as to four elements: (1) acceptance by the buyer of the goods; (2) the price of the goods accepted; (3) the past due date of the price; and (4) the failure of the buyer to pay. Leviton Mfg. Co. v. Butch Mfg. Co., 37 N.C. App. 726, 247 S.E.2d 1, appeal dismissed, 295 N.C. 734, 248 S.E.2d 864 (1978); Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

Evidence Sufficient to Establish Prima Facie Case. — Where the plaintiff-seller presented competent evidence tending to show delivery at invoice prices, acceptance and use of the goods by defendant-buyer, at invoice prices, demand for payment by plaintiff-seller, acknowledgment of the debt and agreement by defendant to pay, and failure to pay, at the close of the plaintiff's evidence which established a prima facie case, the burden of going forward with the evidence had shifted to defendant. Leviton Mfg. Co. v. Butch Mfg. Co., 37 N.C. App. 726, 247 S.E.2d 1, appeal dismissed, 295 N.C. 734, 248 S.E.2d 864 (1978).

§ 25-2-710. Seller's incidental damages.

Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Sections 64 and 70, Uniform Sales Act.

Purposes: To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the principal normal and necessary additional elements of damage flowing from the breach but intends to allow all commercially reasonable expenditures made by the seller.

Definitional Cross References:
"Aggrieved party". Section 1-201.
"Buyer". Section 2-103.
"Goods". Section 2-105.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

North Carolina law recognized that seller is entitled to incidental damages and accords with this section of the UCC. See Vanstory Clothing Co. v. Stadiem, 149 N.C. 6, 62 S.E. 778 (1908); Cole & Sons v. Lumber Co., 150 N.C. 183, 63 S.E. 736 (1909).

Legal Periodicals. — For note on the aggrieved seller's remedies and damages under the UCC, see 12 Wake Forest L. Rev. 495 (1976).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Seller May Recover Expenses Reasonably Incurred. — An acceptance of the goods entitles the aggrieved seller to recover the contract price of the goods as well as any expenses reasonably incurred as a result of the breach. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

In order to prevent the imposition of increased liability on sellers of goods who reasonably exercise their state law rights, when a seller acts in good faith and resells returned goods in a commercially reasonable manner, the amount that may be recovered as a preference is the amount netted by the seller after costs and expenses have been deducted form the gross proceeds of any such sale. American Furn. Outlet USA, Inc. v. Woodmark Originals, Inc., 209 Bankr. 49 (Bankr. M.D.N.C. 1997).

An aggrieved seller (who acts in a commercially reasonable manner) is entitled to recover the costs associated with the care and resale of rejected goods after a buyer's breach. American Furn. Outlet USA, Inc. v. Woodmark Originals, Inc., 209 Bankr. 49 (Bankr. M.D.N.C. 1997).

Effect of Bankruptcy. — Where defendant acted in a commercially reasonable manner and, absent bankruptcy by debtor, would have been entitled to collect costs and expenses associated with the sales as part of its damages claim, it would not be equitable to require defendant to assume those costs simply because the debtor filed bankruptcy. American Furn. Outlet USA, Inc. v. Woodmark Originals, Inc., 209 Bankr. 49 (Bankr. M.D.N.C. 1997).

Applied in Industrial Circuits Co. v. Terminal Communications, Inc., 26 N.C. App. 536, 216 S.E.2d 919 (1975).

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987).

§ 25-2-711. Buyer's remedies in general; buyer's security interest in rejected goods.

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (G.S. 25-2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section [G.S. 25-2-712] as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for nondelivery as provided in this article (G.S. 25-2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

(a) if the goods have been identified recover them as provided in this article (G.S. 25-2-502); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this article (G.S. 25-2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (G.S. 25-2-706). (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
No comparable index section; Subsection (3) — Section 69(5), Uniform Sales Act.

Changes: The prior uniform statutory provision is generally continued and expanded in Subsection (3).

Purposes of Changes and New Matter:

1. To index in this section the buyer's remedies, subsection (1) covering those remedies permitting the recovery of money damages, and subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with that of a seller under this Article except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover or to have damages for nondelivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this Act requires its remedies to be liberally administered

and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References:

Point 1: Sections 2-508, 2-601(c), 2-608, 2-612 and 2-714.

Point 2: Section 2-706.

Point 3: Section 1-106.

Definitional Cross References:

"Aggrieved party". Section 1-201.
"Buyer". Section 2-103.
"Cancellation". Section 2-106.
"Contract". Section 1-201.
"Cover". Section 2-712.
"Goods". Section 2-105.
"Notifies". Section 1-201.
"Receipt" of goods. Section 2-103.
"Remedy". Section 1-201.
"Security interest". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law that upon seller's breach, buyer may cancel contract. See Hajoca Corp. v. Brooks, 249 N.C. 10, 105 S.E.2d 123 (1958). Buyer may also recover so much of the purchase price as he has paid. Robinson v. Huffstetler, 165 N.C. 459, 81 S.E. 753 (1914).

Subsection (1)(a) accords with prior North Carolina law which required the buyer, upon a seller's breach, to make reasonable efforts to protect himself from loss — "to do what reasonable care and business prudence required to minimize the loss." See Mills v. McRae, 187 N.C. 707, 122 S.E. 762 (1924), which indicates that a buyer was chargeable with the duty to attempt to purchase goods of similar quantity and quality in the open market to fix buyer's damages in the event of seller's breach. The burden was on the seller to show that the buyer could have minimized his damages by such "cover" purchase.

Subsection (1)(b) accords with prior law. See Berbarry v. Tombacher, 162 N.C. 497, 77 S.E. 412 (1913); Morrison & Hill v. Marks, 178 N.C. 429, 100 S.E. 890 (1919); Mills v. McRae, 187 N.C. 707, 122 S.E. 762 (1924).

Subsections (2)(a) and (2)(b), allowing buyer to recover the goods themselves upon nondelivery or repudiation, accords with Hughes v. Knott, 140 N.C. 550, 53 S.E. 361 (1906), which indicates that if a seller breached a contract to deliver specified goods and the buyer could show that he was ready, willing and able to perform, the buyer could maintain an action to recover the goods themselves. See also Hughes v. Knott, 138 N.C. 105, 50 S.E. 586 (1905).

Subsection (3), giving buyer a lien on goods for payments made on the price and expenses incurred when the buyer rightfully rejects goods, apparently has no prior statutory or decisional counterpart in North Carolina law. There is likewise apparently no prior law setting out the buyer's right to resell goods rightfully rejected by the buyer, and thus subsection (3) constitutes new material.

Cross References. — As to the New Motor Vehicles Warranties Act, see G.S. 20-351 et seq.

Legal Periodicals. — For article on contract modification under Article 2, see 59 N.C.L. Rev. 335 (1981).

For survey of 1981 commercial law, see 60 N.C.L. Rev. 1238 (1982).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Recovery of Price Paid and Damages. — If the buyer made an effective rejection of a mobile home, or justifiably revoked his acceptance of it, he has a right to recover "so much of the price as had been paid" plus any incidental and consequential damages he is able to prove. Davis v. Colonial Mobile Homes, 28 N.C. App. 13, 220 S.E.2d 802 (1975), cert. denied, 289 N.C. 613, 223 S.E.2d 391 (1976).

There is no relation between the practice of "hedging" and "cover" under the UCC. Ralston Purina Co. v. McFarland, 550 F.2d 967 (4th Cir. 1977).

Failure to Provide Adequate Notification of Revocation. — Where plaintiffs never notified defendant of their revocation of acceptance of defective automobile, plaintiffs were not entitled to damages under this section. Instead, plaintiffs were only entitled to damages for breach of warranty as set forth in G.S. 25-2-714. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Failure to Establish Security Interest. — Bankruptcy court concluded that the claimant's motion for summary judgment, made pursuant to Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056, should be granted based upon the undisputed facts of record and that the debtor's motion for summary judgment should be denied; the court found that the claimant was entitled to invoke the equitable doctrine of recoupment after the court found that the evidence failed to establish a security interest in the showroom furniture in issue in favor of the claimant, as the claimant asserted pursuant to G.S. 25-2-607 and G.S. 25-2-711. In re Lincoln-Gerard USA, Inc., — Bankr. —, 2002 Bankr. LEXIS 1753 (Bankr. M.D.N.C. July 18, 2002).

Applied in Rose v. Epley Motor Sales, 288 N.C. 53, 215 S.E.2d 573 (1975); Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282 (1979); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984).

Cited in Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); Wachovia Bank & Trust Co. v. Smith, 24 N.C. App. 133, 210 S.E.2d 212 (1974); Wachovia Bank & Trust Co. v. Smith, 44 N.C. App. 685, 262 S.E.2d 646 (1980); Harrington Mfg. Co. v. Logan Tontz Co., 53 N.C. App. 625, 281 S.E.2d 423 (1981); Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-712. "Cover"; buyer's procurement of substitute goods.

(1) After a breach within the preceding section [G.S. 25-2-711] the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (G.S. 25-2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case; and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this Article as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or non-merchant consumer is required only to act in normal good faith while the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

Cross References:
Point 1: Section 2-706.
Point 2: Section 1-204.
Point 3: Sections 2-713, 2-715 and 2-716.
Point 4: Section 1-203.

Definitional Cross References:
"Buyer". Section 2-103.
"Contract". Section 1-201.
"Good faith". Section 2-103.
"Goods". Section 2-105.
"Purchase". Section 1-201.
"Remedy". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section accords with prior North Carolina law that buyer, upon learning of seller's breach of contract in failing to deliver, may procure goods of similar quantity and quality in the open market, and recover the difference between the contract price and the reasonable market price for which the substituted goods are purchased. See Mills v. McRae, 187 N.C. 707, 122 S.E. 762 (1924); Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904); Wilson v. Scarboro, 169 N.C. 654, 86 S.E. 611 (1915). This section provides a handy label.

This section makes the price paid by the buyer to effect "cover" pursuant to reasonable good faith efforts determinative, rather than "reasonable market value" in the abstract.

Legal Periodicals. — For note discussing the measure of buyer's damages upon anticipatory repudiation, see 56 N.C.L. Rev. 370 (1978).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Requirements for Remedy of "Cover". — In order to employ the remedy of "cover," the buyer must meet the requirements set out in subsection (1) of this section. First, there must have been a breach of the contract, and the seller must have either repudiated the contract or failed to deliver the goods, or the buyer must have rightfully rejected or justifiably revoked his acceptance of the goods. Second, the buyer must have acted in good faith and without unreasonable delay in procuring the substitute goods. Finally, the replacement goods must be a reasonable substitute for those the buyer contracted to purchase. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979).

There is no relation between the practice of "hedging" and "cover" under the UCC. Ralston Purina Co. v. McFarland, 550 F.2d 967 (4th Cir. 1977).

Damages Not Barred by Failure to Cover. — In a breach of contract action in which plaintiff contended that he justifiably revoked his acceptance of a latches order from defendant after he had paid part of the purchase price and that he properly "covered" by procuring substitute latches for those ordered by defendant, the trial court erred in charging the jury that they would have to find that there had been a justifiable revocation and "cover" to award damages to plaintiff, since damages for "cover" are damages to which plaintiff would be entitled in addition to so much of the purchase price as he had paid if the jury should find that plaintiff "covered" after properly revoking its acceptance. Harrington Mfg. Co. v. Logan Tontz Co., 53 N.C. App. 625, 281 S.E.2d 423 (1981), cert. denied, 305 N.C. 299, 290 S.E.2d 702 (1982).

Applied in B.B. Walker Co. v. Ashland Chem. Co., 474 F. Supp. 651 (M.D.N.C. 1979).

§ 25-2-713. Buyer's damages for nondelivery or repudiation.

(1) Subject to the provisions of this article with respect to proof of market price (G.S. 25-2-723), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental

and consequential damages provided in this article (G.S. 25-2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 67(3), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To clarify the former rule so that:

1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this Article. Such scarcity conditions, moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

Cross References:

Point 3: Sections 1-106, 2-716 and 2-723.
Point 5: Section 2-712.

Definitional Cross References:

"Buyer". Section 2-103.
"Contract". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

The cases in North Carolina agree with this section that the measure of damages for nondelivery or breach by seller is the difference between the agreed price in the contract and the market value of the goods at the time and place specified for performance. Berbarry v. Tombacher, 162 N.C. 497, 77 S.E. 412 (1913); Gaston Farmers' Warehouse Co. v. American Agricultural Chem. Co., 176 N.C. 509, 97 S.E. 472 (1918); Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co., 134 N.C. 574, 47 S.E. 116 (1904).

In addition, the buyer may recover damages arising by reason of special circumstances, if the seller knew of such special circumstances or if such damages were fairly and reasonably within the contemplation of the parties when the contract was made. This section states the standard contract rule of damages. See Tillinghast-Styles Co. v. Providence Cotton Mills, 143 N.C. 268, 55 S.E. 621 (1906). As to incidental damages recoverable, see Waynesville Wood Mfg. Co. v. Berlin Mach. Works, 144 N.C. 689, 57 S.E. 455 (1907), where recovery was allowed for expenses incurred to buyer for attempting to make a machine work at the request of the seller.

Legal Periodicals. — For note discussing the measure of buyer's damages upon anticipatory repudiation, see 56 N.C.L. Rev. 370 (1978).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Applicability of Section. — The terms of this section limit its application to situations where a seller has repudiated the contract by failing to deliver the goods. Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984).

Applied in B.B. Walker Co. v. Ashland Chem. Co., 474 F. Supp. 651 (M.D.N.C. 1979).

Cited in Rose v. Vulcan Materials Co., 282 N.C. 643, 194 S.E.2d 521 (1973); Ralston Purina Co. v. McFarland, 550 F.2d 967 (4th Cir. 1977).

§ 25-2-714. Buyer's damages for breach in regard to accepted goods.

(1) Where the buyer has accepted goods and given notification (subsection (3) of G.S. 25-2-607) he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section [G.S. 25-2-715] may also be recovered. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 69(6) and (7), Uniform Sales Act.

Changes: Rewritten.

Purpose of Changes:

1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "non-conformity" referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such non-conformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for non-delivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide as where the buyer signifies his acceptance upon the tender. If, however, the non-conformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

Cross References:

Point 1: Compare Section 2-711; Sections 2-607 and 2-717.
Point 2: Section 2-106.
Point 3: Sections 2-608 and 2-713.
Point 4: Section 2-715.

Definitional Cross References:

"Buyer". Section 2-103.
"Conform". Section 2-106.
"Goods". Section 1-201.
"Notification". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1) accords with Waynesville Wood Mfg. Co. v. Berlin Mach. Works, 144 N.C. 689, 57 S.E. 455 (1907), and Armour Fertilizer Works v. McLawhorn, 158 N.C. 274, 73 S.E. 883 (1912), that when goods are deficient in quality, the damages sustained is the difference between the value of the goods actually sold and what the value should have been had the terms of the contract been met plus only such damages as were within the contemplation of the parties at the time the contract was made.

Subsection (2) accords with Grossman v. Johnson, 242 N.C. 571, 89 S.E.2d 141 (1955); Harris v. Canady, 236 N.C. 613, 73 S.E.2d 559 (1952); Hendrix v. B & L Motors, Inc., 241 N.C. 644, 86 S.E.2d 448 (1955), that the measure of damages for breach of a warranty in the sale of personal property is the difference between the market value at the time and place of delivery of the goods and the value of the goods as they would have been had they complied with the warranty, with such special damages as were within the contemplation of the parties, including any expenses reasonably incurred in attempting to make the goods conform. See Gulf States Creosoting Co. v. Loving, 120 F.2d 195 (4th Cir. 1941).

Subsection (3) accords with prior North Carolina law. See Harris v. Canady, 236 N.C. 613, 73 S.E.2d 559 (1952).

Legal Periodicals. — For survey of 1980 commercial law, see 59 N.C.L. Rev. 1084 (1981).

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

The general measure of damages for breach of warranty allowed by the UCC under this section is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount. Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980); Simmons v. C.W. Myers Trading Post, Inc., 56 N.C. App. 549, 290 S.E.2d 710, modified, 307 N.C. 122, 296 S.E.2d 294 (1982); Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

The general measure of damages for breach of implied warranty of merchantability is the difference between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount. Wright v. T & B Auto Sales, Inc., 72 N.C. App. 449, 325 S.E.2d 493 (1985).

Plaintiffs never notified defendant of their revocation of acceptance of defective automobile; therefore, plaintiffs were not entitled to damages under G.S. 25-2-711; instead they were entitled to damages for breach of warranty as set forth in this section. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Subsection (2) is not the exclusive measure of damages for breach of warranty. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

Special Damages Under § 25-2-715 Distinguished. — The distinction between general damages under this section and special damages under G.S. 25-2-715 is principally important with regard to the pleadings and quantum of proof. General damages are the natural and necessary result of the wrong, are implied by law, and may be recovered under a general allegation of damages, whereas special damages, those which do not necessarily result from the wrong, must be pleaded, and the facts giving rise to the special damages must be alleged so as to fairly inform the defendant of the scope of plaintiff's demand. Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976).

Amount of Damages Is Question for Jury. — The determination of the amount of damages recoverable was properly a question for the jury upon consideration of all the evidence presented. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

Burden of Proof of Value. — The burden of proving the (1) value the goods would have had if they had been as warranted and (2) the value of the goods as accepted, is on the buyer, and this burden of proof as to damages from breach of the sales contract cannot be met by mere conjecture. HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

The burden of proving the difference in value rests upon the purchaser. Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980); Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301

N.C. 406, 273 S.E.2d 451 (1980).

The value differential formula set out in subsection (2) of this section applies absent a showing of "special circumstances." Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Contract Price May Serve as Strong Evidence of Value of Goods as Warranted. — See HPS, Inc. v. All Wood Turning Corp., 21 N.C. App. 321, 204 S.E.2d 188 (1974).

Remand for Proof of Damages. — Where although there was evidence in the record of a breach of an express warranty regarding the time when engine parts on the car purchased by plaintiff were replaced, there was no evidence as to the value of the vehicle as warranted (with parts replaced within six months) compared to its actual value at the time of acceptance (with parts replaced within one and a half years), the case would be remanded for a new trial with respect to plaintiff's claim for express warranty. Bailey v. LeBeau, 79 N.C. App. 345, 339 S.E.2d 460, modified and aff'd, 318 N.C. 411, 348 S.E.2d 524 (1986), remanding for new trial on issues of breach of express warranty, unfair and deceptive trade practices, as well as damages.

Proof Not Required of Buyer. — Where the manufacturer failed effectively to limit the remedy available to the buyer for breach of warranty other than to exclude consequential damages, it was not necessary to plaintiff's recovery of damages under this section that he prove that any such limitation of remedies had failed of its essential purpose within the meaning of G.S. 25-2-719(2). Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

"Litigation by Consent". — Although the plaintiff failed to formally move to amend its complaint to allow recovery for damages involving special circumstances as under subdivision (2) of this section, under the rule of "litigation by consent," failure by defendant to object to the proffered evidence permitted the trial judge to admit and consider the additional damages. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Offset to Damages. — In an action to recover damages for an alleged breach of warranty by a car dealer and car manufacturer, plaintiff, upon a showing of such breach, would be entitled to recover the difference between the value of the vehicle as accepted and the value of the vehicle had it been as warranted; however, to the extent that the successful elimination of the vibration problem increased the value of the vehicle, defendants should be entitled to offset the damages by an amount representing that increase in value, an amount which defendants should have the burden of proving. The amount of offset to damages would be most fairly computed by determining (1) what the hypothetical depreciated value of the vehicle would have been as of the date the repairs were completed had the vehicle been as warranted, and (2) what the depreciated value of the vehicle was in its defective condition as of that same date not taking into account the repairs made. The difference between those two figures should reflect the amount of offset to damages which the warrantor could claim. Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

Owner Competent to Testify. — Unless it affirmatively appears that the owner does not know the market value of his property, it is generally held that he is competent to testify as to its value even though his knowledge on the subject would not qualify him as a witness were he not the owner. Lyon v. Shelter Resources Corp., 40 N.C. App. 557, 253 S.E.2d 277 (1979).

Applied in Piedmont Plastics, Inc. v. Mize Co., 58 N.C. App. 135, 293 S.E.2d 219 (1982); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Cited in Performance Motors, Inc. v. Allen, 11 N.C. App. 381, 181 S.E.2d 134 (1971); Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); Ace Chem. Corp. v. Atomic Paint Co., 31 N.C. App. 221, 229 S.E.2d 55 (1976); Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980); Olivetti Corp. v. Ames Bus. Sys., 319 N.C. 534, 356 S.E.2d 578 (1987); Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

§ 25-2-715. Buyer's incidental and consequential damages.

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Subsection (2)(b) — Sections 69(7) and 70, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes and New Matter:

1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2)(b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2)(a).

Cross References:

Point 1: Section 2-608.
Point 3: Sections 1-203, 2-615 and 2-719.
Point 4: Section 1-106.

Definitional Cross References:

"Cover". Section 2-712.
"Goods". Section 1-201.
"Person". Section 1-201.
"Receipt" of goods. Section 2-103.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

This section generally restates prior North Carolina law.

Subsection (1) accords with prior North Carolina law that incidental and consequential damages for breach of contract which are within the contemplation of the parties are recoverable by buyer from the seller. See Neal v. Pender-Hyman Hardware Co., 122 N.C. 104, 29 S.E. 96 (1898); Lambert Hoisting Engine Co. v. Paschall, 151 N.C. 27, 65 S.E. 523 (1909).

Remote and speculative damages or damages beyond the contemplation of the parties are not recoverable. Armour Fertilizer Works v. McLawhorn, 158 N.C. 274, 73 S.E. 883 (1912).

Subsections (2) (a) and (b) accord with prior North Carolina law. See, e.g., Harris v. Canady, 236 N.C. 613, 73 S.E.2d 559 (1952); Hanrahan v. Walgreen Co., 243 N.C. 268, 90 S.E.2d 392 (1955), that a buyer has a right to recover incidental, consequential or foreseeable damages which are the proximate result of a breach of warranty. Davis v. Radford, 233 N.C. 283, 63 S.E.2d 822 (1951).

Legal Periodicals. — For note discussing the measure of buyer's damages upon anticipatory repudiation, see 56 N.C.L. Rev. 370 (1978).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

CASE NOTES

Purpose of Point 4 of Official Comment to Section. — It was to bring the law into harmony with the market place that the draftsmen of the Uniform Commercial Code said in Point 4 of the Official Comment to this section: "The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances." Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

General Damages Under § 25-2-714 Distinguished. — The distinction between general damages under G.S. 25-2-714 and special damages under this section is principally important with regard to the pleadings and quantum of proof. General damages are the natural and necessary result of the wrong, are implied by law, and may be recovered under a general allegation of damages. But special damages, those which do not necessarily result from the wrong, must be pleaded, and the facts giving rise to the special damages must be alleged so as to fairly inform the defendant of the scope of plaintiff's demand. Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976).

Incidental damages are those that are causally related to the breach. B.B. Walker Co. v. Ashland Chem. Co., 474 F. Supp. 651 (M.D.N.C. 1979).

Incidental and consequential damages are special damages, those which do not necessarily result from the wrong. Piedmont Plastics, Inc. v. Mize Co., 58 N.C. App. 135, 293 S.E.2d 219 (1982).

Proximate Cause Required for Consequential Damages. — Without proximate cause of the injury by the breach of the warranty, consequential damages are not recoverable. Edwards v. ATRO Spa, 891 F. Supp. 1074 (E.D.N.C. 1995).

When Prospective Profits from Established Mercantile Business Are Recoverable. — It may be stated as a general rule that the prospective profits from an established mercantile business, prevented or interrupted by breach of contract, are properly the subject of recovery when it is made to appear (1) that it is reasonably certain that such profits would have been realized except for the breach of the contract, (2) that such profits can be ascertained and measured with reasonable certainty, and (3) that such profits may be reasonably supposed to have been within the contemplation of the parties, when the contract was made, as the probable result of a breach. Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

The owner of a knitting mill was not entitled to recover the loss of anticipated profits where the effect on the owner's profits of the contractor's breach of production requirements of a contract to construct a yarn-spinning mill was so remote as to be speculative. Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

Operating Losses. — Operating losses are special damages which must be alleged under G.S. 1A-1, Rule 9(g) and are consequential damages which are recoverable under subsection (2) of this section if defendant knew or reasonably could have foreseen that the probable result of a malfunctioning product would be such operating losses. Rodd v. W.H. King Drug Co., 30 N.C. App. 564, 228 S.E.2d 35 (1976).

Where the contractor, experienced in the design and construction of spinning mills, knew or reasonably could have foreseen that the probable result of an ill-equipped mill would be a decrease in production, shoddy yarn, and an increase in operating expenses, such operating losses are foreseeable and are recoverable as damages. Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972).

Special damages must be pleaded, and the facts giving rise to them must be alleged so as to fairly inform the defendant of the scope of plaintiff's demand. Piedmont Plastics, Inc. v.

Mize Co., 58 N.C. App. 135, 293 S.E.2d 219 (1982).

When Instruction on Special Damages Is Proper. — An instruction on special damages is appropriate only when such damages are particularly alleged in the complaint and the allegation is sustained by the evidence. Piedmont Plastics, Inc. v. Mize Co., 58 N.C. App. 135, 293 S.E.2d 219 (1982).

Applied in Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282 (1979); Danjee, Inc. v. Addressograph Multigraph Corp., 44 N.C. App. 626, 262 S.E.2d 665 (1980); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Cited in Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972); Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987); Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

§ 25-2-716. Buyer's right to specific performance or replevin.

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family, or household purposes, the buyer's right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 2000-169, s. 12.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Prior Uniform Statutory Provision: Section 68, Uniform Sales Act.

Changes: Rephrased.

Purposes of Changes: To make it clear that:

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

3. The legal remedy of replevin is given to the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods under Section 2-502. For consumer goods, the buyer's right to replevin vests upon the buyer's acquisition of a special property, which occurs upon identification of the goods to the contract. See Section 2-501. Inasmuch as a secured party normally acquires no greater rights in its collateral that its debtor had or had power to convey, see Section 2-403(1) (first sentence), a buyer who acquires a right of replevin under subsection (3) will take free of a security interest created by the seller if it attaches to the goods after the goods have been identified to the contract. The buyer will take free, even if the buyer does not buy in ordinary course and even if the security interest is perfected. Of course, to the extent

that the buyer pays the price after the security interest attaches, the payments will constitute proceeds of the security interest.

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article 7, especially Section 7-602.

Cross References:

Point 3: Section 2-502.
Point 4: Section 2-709.
Point 5: Article 7.

Definitional Cross References:

"Buyer". Section 2-103.
"Goods". Section 1-201.
"Rights". Section 1-201.

NORTH CAROLINA COMMENT

Subsections (1) and (2) spell out by statute that specific performance may be decreed as to contracts for the sale of goods. Prior North Carolina law provided generally that no specific performance of contracts relating to personal property would be compelled. Virginia Trust Co. v. Webb, 206 N.C. 247, 173 S.E. 598 (1934); Tobacco Growers Ass'n v. Battle, 187 N.C. 260, 121 S.E. 629 (1924). However, even in North Carolina, the court granted specific performance where damages at law for breach would not afford a complete remedy. Virginia Trust Co. v. Webb, 206 N.C. 247, 173 S.E. 598 (1934); Misenheimer v. Alexander, 162 N.C. 226, 78 S.E. 161 (1913); Williams v. Howard, 7 N.C. 74 (1819).

The Code gives the court more leeway in granting specific performance of personal property sales contracts "in other proper circumstances."

Note : Subsection (3) refers to the old action of replevin which is now "claim and delivery" under North Carolina statute (GS 1-472).

It seems that "claim and delivery" could, under prior North Carolina law, be employed to obtain the subject matter of a contract for the sale of personal property if legal title to the property had passed. See Holmes v. Godwin, 69 N.C. 467 (1873).

The UCC does not require any determination of "title" as a condition precedent but allows the buyer to replevy specific goods identified to a contract in the event that "cover" cannot be reasonably effected.

Cross References. — As to action for claim and delivery as substitute for common-law action of replevin, see G.S. 1-472 to 1-484 and notes thereto.

Legal Periodicals. — For note discussing liquidated damages, specific performance and other remedies for breach of cotton sales contracts, see 53 N.C.L. Rev. 579 (1974).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

Specific Performance Unwarranted. — Where furniture which the objecting customer was seeking to obtain was of the type which could be easily purchased from furniture manufacturers and other retailers in the geographical area where debtor was located, furniture was not so unique as to merit specific performance. In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

Replevin Unavailable. — Where there was no evidence that an objecting customer made reasonable efforts to effect cover for furniture in possession of debtor, and customer would not be unable to effect cover, replevin was unavailable. In re Surplus Furn. Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

Applied in Byrd Motor Lines v. Dunlop Tire & Rubber Corp., 63 N.C. App. 292, 304 S.E.2d 773 (1983); Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983).

§ 25-2-717. Deduction of damages from the price.

The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
See Section 69(1)(a), Uniform Sales Act.

Purposes:

1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this Article, no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

Cross Reference:
Point 2: Section 2-609.

Definitional Cross References:
"Buyer". Section 2-103.
"Notifies". Section 1-201.

NORTH CAROLINA COMMENT

This section accords with prior North Carolina law. See Howie v. Rea, 70 N.C. 559 (1874), which holds that a buyer is permitted to deduct damages in an action for price where the contract has been breached in part by the seller.

The notice requirement of this section of the UCC, however, is a new innovation.

This section does not affect North Carolina's law of set-off and counterclaim as provided in GS 1-137.

§ 25-2-718. Liquidation or limitation of damages; deposits.

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1),
(b) in the absence of such terms, twenty per cent (20%) of the value of the total performance for which the buyer is obligated under the contract or five hundred dollars ($500.00), whichever is smaller, or
(c) at the election of the seller in the case of a layaway contract, the aggregate payments received by seller from buyer under the contract or fifty dollars ($50.00), whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this article other than subsection (1), and
(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this article on resale by an aggrieved seller (G.S. 25-2-706). (1965, c. 700, s. 1; 1993, c. 340, s. 2.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:

1. Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

Cross References:
Point 1: Section 2-302.
Point 2: Section 2-706.

Definitional Cross References:
"Aggrieved party". Section 1-201.
"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Goods". Section 2-105.
"Notice". Section 1-201.
"Party". Section 1-201.
"Remedy". Section 1-201.
"Seller". Section 2-103.
"Term". Section 1-201.

NORTH CAROLINA COMMENT

Subsection (1) accords with the general law applicable in North Carolina as to liquidated damages. See Crawford v. Allen, 189 N.C. 434, 127 S.E. 521 (1925), and Horn v. Poindexter, 176 N.C. 620, 97 S.E. 653 (1918), which hold that where there is a marked disproportion between the amount fixed upon as liquidated damages in the contract and the damages actually likely to arise from a breach so as to render the amount fixed upon unreasonable or oppressive, it is void as being a penalty and it is not binding. The actual damages can be inquired into notwithstanding such provision. If the amount specified is not unjust, oppressive, or disproportionate to the damages that would likely result from a breach of contract, a provision for liquidated damages would be valid. See Tobacco Growers Co-op Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923).

Subsections (2), (3) and (4) have no prior statutory or decisional parallels in North Carolina law and are therefore new to North Carolina law.

CASE NOTES

A contractual clause authorizing specific performance is different in kind from a liquidated damages clause. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

To find unconscionability there must be an absence of meaningful choice on part of one of the parties together with contract terms which are unreasonably favorable to the other. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Expansion of Seller's Remedies Not Unconscionable. — Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Applied in Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976).

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987); Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

§ 25-2-719. Contractual modification or limitation of remedy.

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section [G.S. 25-2-718] on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this chapter.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:

1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

2. Subsection (1)(b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2-316.

Cross References:
Point 1: Section 2-302.
Point 3: Section 2-316.

Definitional Cross References:
"Agreement". Section 1-201.
"Buyer". Section 2-103.
"Conforming". Section 2-106.
"Contract". Section 1-201.
"Goods". Section 2-105.
"Remedy". Section 1-201.
"Seller". Section 2-103.

NORTH CAROLINA COMMENT

Subsection (1)(a) accords with prior North Carolina law as expressed in Allen v. Tompkins, 136 N.C. 208, 48 S.E. 655 (1904), that the parties to a sales contract can limit their liability and remedies by the terms of their contract (to making repairs, furnishing other goods, etc.).

Subsection (1)(b) has no prior decisional or statutory counterpart in North Carolina law.

Subsection (2) has no prior decisional or statutory counterpart in North Carolina law.

Subsection (3): The first sentence of subsection (3) accords, at least in part, with Hampton Guano Co. v. Live-Stock Co., 168 N.C. 442, 84 S.E. 774 (1915), and Carter v. McGill, 171 N.C. 775, 89 S.E. 28 (1916), where it is held that a seller may limit his liability by inserting in his sales contract a provision that he shall not be liable for certain results.

The second sentence of subsection (3), making limitations as to consequential damages for injuries to persons prima facie unconscionable when goods are consumer goods, has no prior decisional or statutory parallel in North Carolina. The UCC provision does not create a prima facie presumption of unconscionability of limitations of liability in commercial contracts.

(*Note:* While it is stated above that there is no prior statutory nor decisional parallel to subsection (3)'s provisions making limitations of liability prima facie unconscionable with regard to consumer goods, this subsection (3) in principle in this regard is not unlike the contracts principle that a party cannot protect himself by contract from liability for his own negligence in the performance of a duty of public service, or where a public duty is owed, or public interest is involved, or where public interest requires performance of a private duty. See Hall v. Sinclair, 242 N.C. 707, 89 S.E.2d 396 (1955). This subsection seems to clothe sales of consumer goods with a protection against limitations of liability on the part of sellers as a matter of public policy with reference to consumer goods where injuries to the person may be involved.)

Legal Periodicals. — For note on strict liability for breach of warranty, see 50 N.C.L. Rev. 697 (1972).

For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For note discussing liquidated damages, specific performance and other remedies for breach of cotton sales contracts, see 53 N.C.L. Rev. 579 (1974).

For note on requirement of privity and express warranties, see 16 Wake Forest L. Rev. 857 (1980).

For survey of 1980 commercial law, see 59 N.C.L. Rev. 1084 (1981).

For survey of 1981 commercial law, see 60 N.C.L. Rev. 1238 (1982).

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

CASE NOTES

This Section and § 25-2-316 Distinguished. — Although G.S. 25-2-316 and this section are closely related, the former is directed to the creation of a limited duty under the warranty, whereas the latter is directed to the limitation of the remedy available in the event of a breach of that duty. Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

Disclaimer and Substitution of Liabilities Under This Section. — A merchant seller may disclaim all liability under G.S. 25-2-316(2) stemming from any breach of warranties of merchantability and fitness under G.S. 25-2-314 and 25-2-315, substituting in place thereof the limitations of subdivision (1)(a) of this section. Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

Remedy Provided for in Express Warranty Controlling. — In an action by plaintiff-buyer against defendant-manufacturer under an express warranty, which provides for a remedy in substitution for the general rule of damages applicable to breach of contract for sale of personal property, the remedy provided for in the express warranty is controlling, at least where such provisions meet the general tests of legality. Richard W. Cooper Agency, Inc. v. Irwin Yacht & Marine Corp., 46 N.C. App. 248, 264 S.E.2d 768 (1980).

Presumption That Remedies Are Cumulative. — Subsection (1) (b) of this section creates a presumption that, in the absence of a clear expression to the contrary, remedies are cumulative rather than exclusive. Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

Expansion of Remedy Beyond Commercial Code Not Unconscionable. — Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Under this section, a remedy stated in the contract is optional unless the remedy is expressly agreed to be exclusive. Foley v. L & L Int'l, Inc., 88 N.C. App. 710, 364 S.E.2d 733 (1988).

Remedy Failing of Essential Purpose. — Where a defect in a truck was not or could not be repaired within a reasonable period as required by a warranty limiting the remedy available to the purchaser in the event of a breach to repair or replacement of parts, the limited, exclusive remedy "fails of its essential purpose" within the meaning of subsection (2) of this section, and the purchaser is entitled to recover damages as otherwise provided in the UCC.

Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980).

When Proving Such Failure Not Required. — Where the manufacturer failed effectively to limit the remedy available to the buyer for breach of warranty other than to exclude consequential damages, it was not necessary to plaintiff's recovery of damages under G.S. 25-2-714 that he prove that any such limitation of remedies had failed of its essential purpose within the meaning of subsection (2). Williams v. Hyatt Chrysler-Plymouth, Inc., 48 N.C. App. 308, 269 S.E.2d 184, cert. denied, 301 N.C. 406, 273 S.E.2d 451 (1980).

Unconscionability relates to contract terms that are oppressive. It is applicable to one-sided provisions, denying the contracting party any opportunity for meaningful choice. Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975), aff'd, 290 N.C. 502, 226 S.E.2d 321 (1976).

It is rare that a limitation of remedy will be held unconscionable in a commercial setting since the relationship between business parties is usually not so one-sided as to force an unconscionable limitation on a party. Byrd Motor Lines v. Dunlop Tire & Rubber Corp., 63 N.C. App. 292, 304 S.E.2d 773 (1983), cert. denied, 310 N.C. 624, 315 S.E.2d 689 (1984).

Applied in Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976); Stan D. Bowles Distrib. Co. v. Pabst Brewing Co., 69 N.C. App. 341, 317 S.E.2d 684 (1984).

Cited in Gurney Indus., Inc. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972); Maybank v. S.S. Kresge Co., 46 N.C. App. 687, 266 S.E.2d 409 (1980).

§ 25-2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach.

Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purpose:
This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention to forego them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights", or the like, it cannot be considered to be a renunciation under this section.

Cross Reference:
Section 1-107.

Definitional Cross References:
"Cancellation". Section 2-106.
"Contract". Section 1-201.

NORTH CAROLINA COMMENT

There are no prior cases or statutes in North Carolina relating to accidental or unintended consequences as the result of the misuse of the words "cancel" or "rescind" which this section was designed to remedy. Entirely new material.

§ 25-2-721. Remedies for fraud.

Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. This section thus makes it clear that neither rescission of the contract for fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.

Definitional Cross References:

"Contract for sale". Section 2-106.

"Goods". Section 1-201.

"Remedy". Section 1-201.

NORTH CAROLINA COMMENT

The second sentence of this section makes a fundamental change in North Carolina law.

Under prior North Carolina law if a person discovered that he had been induced to buy goods by the actionable fraud of another, he might elect to choose between two inconsistent courses with reference to his purchase. He might either affirm the contract or repudiate it. But he could not do both, either in whole or in part. He might rescind, place the seller in status quo, and recover any portion of the purchase price which he might have paid. Or he might elect to affirm the contract, retain whatever advantage he had received. When he affirmed the contract, it became validated; the purchaser became liable for the purchase price. He might counterclaim or sue in an independent action for damages sustained as a result of the fraud of the seller. See Hutchins v. Davis, 230 N.C. 67, 52 S.E.2d 210 (1949).

Under this UCC section the law of North Carolina is changed. Rescission for fraud will no longer ban other remedies unless the particular circumstances of the case make the remedies incompatible. Under this UCC provision, in proper cases, the buyer may both rescind and recover damages.

CASE NOTES

Cited in Olivetti Corp. v. Ames Bus. Sys., 319 N.C. 534, 356 S.E.2d 578 (1987).

§ 25-2-722. Who can sue third parties for injury to goods.

Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) either party may with the consent of the other sue for the benefit of whom it may concern. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance both parties may have the right of action if the seller retains possession or otherwise retains an interest.

Definitional Cross References:
"Action". Section 1-201.
"Buyer". Section 2-103.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Party". Section 1-201.
"Rights". Section 1-201.
"Security interest". Section 1-201.

NORTH CAROLINA COMMENT

This section apparently changes prior North Carolina law concerning who can bring an action for tortious injury or conversion against a third person. The prior law made "title" determinative. See Peed v. Burleson's, Inc., 244 N.C. 437, 94 S.E.2d 351 (1956). Under this section of the Code a right of action is given to any person who has an insurable interest in the goods.

§ 25-2-723. Proof of market price; time and place.

(1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (G.S. 25-2-708 or G.S. 25-2-713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this article is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise. (1965, c. 700, s. 1; 1967, c. 562, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this Article against surprise, however, a party intending to offer evidence of such a substitute price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

Definitional Cross References:
"Action". Section 1-201.
"Aggrieved party". Section 1-201.
"Goods". Section 2-105.
"Notifies". Section 1-201.
"Party". Section 1-201.
"Reasonable time". Section 1-204.
"Usage of trade". Section 1-205.

NORTH CAROLINA COMMENT

Subsection (1) provides that if an action based on anticipatory breach of contract comes to trial before the time for performance, the measure of damages shall be the difference between the contract price and the price of the goods prevailing at the time the aggrieved party learns of the breach. See GS 25-2-610. This subsection will change the rule in effect previously in North Carolina, that damages for anticipatory breach of contract were to be assessed on the basis of profit factors existent at the time of performance fixed by contract, not at the time of repudiation. See McJunkin Corp. v. North Carolina Natural Gas Corp., 300 F.2d 794 (4th Cir. 1961).

This subsection is designed to obviate difficulties of determining damages in anticipatory breaches.

Subsections (2) and (3) apparently change prior North Carolina law. The ordinary rule upon breach of contract is that the measure of damages is the difference between the contract price and market value at the time and place where the goods should have been delivered by the terms of the contract. See, e.g., Jeanette v. Hovey, 184 N.C. 140, 113 S.E. 665 (1922); Berbarry v. Tombacher, 162 N.C. 497, 77 S.E. 412 (1913). The UCC provisions establish the admissibility of evidence of market prices at other times and places than the time and place for performance of the contract if such evidence, by usages of trade and commercial judgment, is reasonably relevant in determining the damages for nonperformance at a particular time or place. The substituted market price evidence is only admissible if other evidence of market price is unavailable or not readily available.

This rule is new in North Carolina although North Carolina has previously held that testimony of value of a chattel where there is a market for it, making due allowance for expenses of transportation and sale, may be taken as the basis for ascertaining its value at some other place. See Suttle v. Falls, 98 N.C. 393, 4 S.E. 541 (1887). It has also been held that the value of an item within a reasonable time after its conversion or destruction is competent as bearing upon its value at the time it was converted or destroyed. Newsom v. Gothran, 185 N.C. 161, 116 S.E. 415 (1923).

Legal Periodicals. — For note discussing the measure of buyer's damages upon anticipatory repudiation, see 56 N.C.L. Rev. 370 (1978).

§ 25-2-724. Admissibility of market quotations.

Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility. (1965, c. 700, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

Definitional Cross References:
"Goods". Section 2-105.

NORTH CAROLINA COMMENT

This section accords with prior North Carolina cases permitting evidence as to price or value through commercial circulars, market reports and newspaper price quotations. See Smith v. North Carolina R.R., 68 N.C. 107 (1873); Fairley v. Smith, 87 N.C. 367 (1882); Suttle v. Falls, 98 N.C. 393, 4 S.E. 541 (1887); Moseley v. Johnson, 144 N.C. 257, 56 S.E. 922 (1907), on the theory that "it is from such sources and by such means that merchants and businessmen generally come to have information and knowledge as to the methods, customs and courses of trade and business, and the market value and current prices of classes of goods, articles, and things put upon and sold in the markets of the country."

§ 25-2-725. Statute of limitations in contracts for sale.

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within twelve months after the termination of the first action.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this chapter becomes effective. (1965, c. 700, s. 1; 1967, c. 562, s. 1.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Article takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun within the four year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this Article does not purport to alter or modify in any respect the law on tolling of the Statute of Limitations as it now prevails in the various jurisdictions.

Definitional Cross References:
"Action". Section 1-201.
"Aggrieved party". Section 1-201.
"Agreement". Section 1-201.
"Contract for sale". Section 2-106.
"Goods". Section 2-105.
"Party". Section 1-201.
"Remedy". Section 1-201.
"Term". Section 1-201.
"Termination". Section 2-106.

NORTH CAROLINA COMMENT

Subsection (1) changes prior North Carolina law. Under GS 1-52 an action arising out of a simple, nonsealed contract had a statute of limitations of three years from the accrual of the cause of action. Under GS 1-47 (2) the statute of limitations upon actions arising out of sealed instruments was ten years.

Subsection (2): In addition, a cause of action is made to accrue when a breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. This rule is contrary to that now applicable in North Carolina that in an action based on fraud or mistake, the action must be begun within three years of the discovery of the fraud but the statute of limitations does not begin to run until the date of the discovery of the fraud or mistake, or from the time it should have been discovered in the exercise of due diligence. See GS 1-52 (9); Wimberly v. Washington Furniture Stores, 216 N.C. 732, 6 S.E.2d 512 (1939).

Subsection (3) is a saving provision which will preserve existing causes of action which might otherwise be barred by the adoption of the UCC, specifying a time within which such actions must be brought.

Subsection (4) preserves the prior law as to tolling of limitations.

Cross References. — As to three year statute of limitations for actions upon contracts generally, see G.S. 1-52. As to two year statute of limitations for actions against a local unit of government upon a contract, see G.S. 1-53. As to effective date of this Chapter, see G.S. 25-10-101.

Legal Periodicals. — For comment on the liability of the bailor for hire for personal injuries caused by defective goods, see 51 N.C.L. Rev. 786 (1973).

For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

CASE NOTES

Intent of Code. — The UCC was not intended to shield manufacturers of defective products from indemnity claims made by their purchasers more than four years from the date of sale by the manufacturer. Walker Mfg. Co. v. Dickerson, Inc., 619 F.2d 305 (4th Cir. 1980).

Applicability. — The provisions of this section are inapplicable to anything other than the pure sales aspects of a transaction. Hudson v. Game World, Inc., 126 N.C. App. 139, 484 S.E.2d 435 (1997).

Section Inapplicable Where Bodily Injury Is Part of Claim. — The North Carolina Supreme Court has declined to apply this section to claims for breach of warranties under the UCC where bodily injury to the person is an essential element of the cause of action and has instead adopted as the appropriate statute of limitation the three-year period contained in G.S. 1-52(1). Smith v. Cessna Aircraft Co., 571 F. Supp. 433 (M.D.N.C. 1983).

When Statute of Limitations Begins to Run. — Where one person's liability for a tort or breach of warranty committed by another is secondary, the statute of limitations does not start running against his right to indemnity from the party primarily liable until he has paid damages to the injured party. Walker Mfg. Co. v. Dickerson, Inc., 619 F.2d 305 (4th Cir. 1980).

Statute of limitations on breach of express and implied warranties began to run on the date of installation of the equipment purchased, when the warranties were alleged to have been made to the purchaser. Bobbitt v. Tannewitz, 538 F. Supp. 654 (M.D.N.C. 1982).

Plea of Statute of Limitation as Notice of Lack of Justiciable Issue. — When defendant's answer raising the statute of limitations defense was filed and served, it should have become apparent to plaintiff that, barring circumstances permitting the statute of limitations to be tolled, the complaint no longer contained a justiciable issue. Sunamerica Fin. Corp. v. Bonham, 328 N.C. 254, 400 S.E.2d 435 (1991).

In an action to recover a deficiency remaining after repossession and sale of collateral security, where the defendant had purchased a motor vehicle on credit, executing a purchase money security agreement giving the seller a purchase money security interest in the vehicle and retaining title in the seller or its assignees until the purchase price was fully paid, and where the defendant immediately defaulted, the 10-year limitation of G.S. 1-47(2) was applicable, rather than the four-year limitation of this section. North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978).

The plain language of Article 2 of the North Carolina UCC and subsequent legislative history indicate that the North Carolina legislature intended Article 9 to govern the security aspects of purchase money security agreements, and that accordingly, the 10-year limitation of G.S. 1-47(2), and not the four-year limitation of this section, is applicable to such agreements executed under seal. North Carolina Nat'l Bank v. Holshouser, 38 N.C. App. 165, 247 S.E.2d 645 (1978).

Contracts for the sale of timber to be cut are governed by Article 2 of the UCC, pursuant to G.S. 25-2-107(2); accordingly, the controlling statute is subsection (1) of this section, which provides for a four year period of limitation, and not the three year statute of limitations in G.S. 1-52. Mills v. New River Wood Corp., 77 N.C. App. 576, 335 S.E.2d 759 (1985).

Arbitration Is Neither an "Action" Nor a "Judicial Proceeding". — By its terms, the limitations period stated in this section applies only to an "action," which, under G.S. 25-1-201(1) is a "judicial proceeding," and an arbitration is neither an "action" nor a "judicial proceeding," but a nonjudicial, out-of-court proceeding which makes an action or judicial proceeding unnecessary. In re Cameron, 91 N.C. App. 164, 370 S.E.2d 704 (1988).

Summary Judgment Inappropriate in Case Against Town. — Where a laundry owner sued a town regarding dirty water, summary judgment was inappropriate as to the owner's claim for breach of the implied warranty of merchantability because: (1) without being able to inspect the water prior to purchase, the owner could not determine whether the water was fit for use; and (2) under G.S. 1-53, the owner could sue for any damages that occurred within two years prior to filing the lawsuit. Jones v. Town of Angier, — N.C. App. —, 638 S.E.2d 607, 2007 N.C. App. LEXIS 67 (2007).

Action Barred. — Where the manufacturer's express warranty of a mobile home purchased by plaintiffs covered a period of approximately one year, where defendant tendered delivery of the mobile home in April 1986, and where plaintiffs noticed water damage over four years later in September 1990 but did not file their complaint until 9 April 1991, plaintiff had no right to recovery under the manufacturer's express warranty due to its expiration, and having filed their complaint on 9 April 1991, plaintiffs also failed to commence their action within four years after defendant tendered delivery. Reece v. Homette Corp., 110 N.C. App. 462, 429 S.E.2d 768 (1993).

Contract which a buyer and a seller concluded for the purchase of a mobile home was governed by North Carolina's Uniform Commercial Code because the predominant factor of the contract was the delivery of the mobile home, and services provided to install it were incidental, and the trial court ruled correctly that the buyer and seller's contract reduced the time for filing an action for breach of contract from four years to one year, pursuant to G.S. 25-2-725(1), and that the buyer's action against the seller was time-barred. Hensley v. Ray's Motor Co. of Forest City, Inc., 158 N.C. App. 261, 580 S.E.2d 721, 2003 N.C. App. LEXIS 1050 (2003).

Applied in Gillespie v. American Motors Corp., 51 N.C. App. 535, 277 S.E.2d 100 (1981); Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Cited in Hall v. Gurley Milling Co., 347 F. Supp. 13 (E.D.N.C. 1972); Hager v. Brewer Equip. Co., 17 N.C. App. 489, 195 S.E.2d 54 (1973); North Carolina State Ports Auth. v. Lloyd A. Fry Roofing Co., 32 N.C. App. 400, 232 S.E.2d 846 (1977); Bolick v. American Barmag Corp., 306 N.C. 364, 293 S.E.2d 415 (1982); Coe v. Thermasol, Ltd., 785 F.2d 511 (4th Cir. 1986); Cellu Prods. Co. v. G.T.E. Prods. Corp., 81 N.C. App. 474, 344 S.E.2d 566 (1986); American Multimedia, Inc. v. Freedom Distrib., Inc., 95 N.C. App. 750, 384 S.E.2d 32 (1989); Haywood Street Redevelopment Corp. v. Harry S. Peterson, Co., 120 N.C. App. 832, 463 S.E.2d 564 (1995); Hudson v. Game World, Inc., 126 N.C. App. 139, 484 S.E.2d 435 (1997).

ARTICLE 2A.

Leases.

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PART 1.

General Provisions.

§ 25-2A-101. Short title.

This Article shall be known and may be cited as the Uniform Commercial Code — Leases. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Rationale for Codification: There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases. Yet the distinction between a lease and a security interest disguised as a lease is not clear. Second, will the lessor be deemed to have made warranties to the lessee? If the transaction is a sale the express and implied warranties of Article 2 of the Uniform Commercial Code apply. However, the warranty law with respect to leases is uncertain. Third, what remedies are available to the lessor upon the lessee's default? If the transaction is a security interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured Transactions (Article 9). There is no clear answer with respect to leases.

There are reasons to codify the law with respect to leases of goods in addition to those suggested by a review of the reported cases. The answer to this important question should not be limited to the issues raised in these cases. It is not also proper to determine the remedies available to the lessee upon the lessor's default? It is, but that issue is not reached through a review of the reported cases. This is only one of the many issues presented in structuring, negotiating and documenting a lease of goods.

Statutory Analogue: After it was decided to proceed with the codification project, the drafting committee of the National Conference of Commissioners on Uniform State Laws looked for a statutory analogue, gradually narrowing the focus to the Article on Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transactions frequently are without counsel; the agreement of the parties often is oral or evidenced by scant writings; obligations between the parties are bilateral; applicable law is influenced by the need to preserve freedom of contract. A review of the literature with respect to personal property security law reveals that Article 9 is predicated upon very different assumptions: Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced to a writing, extensive in scope; the obligations between the parties are essentially unilateral; and applicable law seriously limits freedom of contract.

The lease is closer in spirit and form to the sale of goods than to the creation of a security interest. While parties to a lease are sometimes represented by counsel and their agreement is often reduced to a writing, the obligations of the parties are bilateral and the common law of leasing is dominated by the need to preserve freedom of contract. Thus the drafting committee concluded that Article 2 was the appropriate statutory analogue.

Issues: The drafting committee then identified and resolved several issues critical to codification:

Scope: The scope of the Article was limited to leases (Section 2A-102). There was no need to include leases intended as security, i.e., security interests disguised as leases, as they are adequately treated in Article 9. Further, even if leases intended as security were included, the need to preserve the distinction would remain, as policy suggests treatment significantly different from the accorded leases.

Definition of Lease: Lease was defined to exclude leases intended as security (Section 2A-103(1)(j)). Given the litigation to date a revised definition of security interest was suggested for inclusion in the Act. (Section 1-201(37)). This revision sharpens the distinction between leases and security interests disguised as leases.

Filing: The lessor was not required to file a financing statement against the lessee or take any other action to protect the lessor's interest in the goods (Section 2A-301). The refined definition of security interest will more clearly signal the need to file to potential lessors of goods. Those lessors who are concerned will file a protective financing statement (Section 9-408).

Warranties: All of the express and implied warranties of the Article on Sales (Article 2) were included (Sections 2A-210 through 2A-216), revised to reflect differences in lease transactions. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Further, many courts have reached the same decision.

Certificate of Title Laws: Many leasing transactions involve goods subject to certificate of title statutes. To avoid conflict with those statutes, this Article is subject to them (Section 2A-104(1)(a)).

Consumer Leases: Many leasing transactions involve parties subject to consumer protection statutes or decisions. To avoid conflict with those laws this Article is subject to them to the extent provided in (Section 2A-104(1)(c) and (2)). Further, certain consumer protections have been incorporated in the Article.

Finance Leases: Certain leasing transactions substitute the supplier of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like. The definition of finance (Section 2A-103(1)(g)) was developed to describe these transactions. Various sections of the Article implement the substitution of the supplier for the lessor, including Sections 2A-209 and 2A-407. No attempt was made to fashion a special rule where the finance lessor is an affiliate of the supplier of goods; this is to be developed by the courts, case by case.

Sale and Leaseback: Sale and leaseback transactions are becoming increasingly common. A number of state statutes treat transactions where possession is retained by the seller as fraudulent *per se* or *prima facie* fraudulent. That position is not in accord with modern practice and thus is changed by the Article "if the buyer bought for value and in good faith" (Section 2A-308(3)).

Remedies: The Article has not only provided for lessor's remedies upon default by the lessee (Sections 2A-523 through 2A-531), but also for lessee's remedies upon default by the lessor (Sections 2A-508 through 2A-522). This is a significant department for Article 9, which provides remedies only for the secured party upon default by the debtor. This difference is compelled by the bilateral nature of the obligations between the parties to a lease.

Damages: Many leasing transactions are predicated on the parties' ability to stipulate an appropriate measure of damages in the event of default. The rule with respect to sale of goods (Section 2-718) is not sufficiently flexible to accommodate this practice. Consistent with the common law emphasis upon freedom to contract, the Article has created a revised rule that allows greater flexibility with respect to leases of goods (Section 2A-504(1)).

History: This Article is a revision of the Uniform Personal Property Leasing Act, which was approved by the National Conference of Commissioners on Uniform State Laws in August, 1985. However, it was believed that the subject matter of the Uniform Personal Property Leasing Act would be better treated as an article of this Act. Thus, although the Conference promulgated the Uniform Personal Property Leasing Act as a Uniform Law, activity was held in abeyance to allow time to restate the Uniform Personal Property Leasing Act as Article 2A.

In August, 1986 the Conference approved and recommended this Article (including conforming amendments to Article 1 and Article 9 for promulgation as an amendment to this Act. In December, 1986 the Council of the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In March, 1987 the Permanent Editorial Board for the Uniform Commercial Code approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In May, 1987 the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In August, 1987 the Conference confirmed its approval of the final text of this Article.

Upon its initial promulgation, Article 2A was rapidly enacted in several states, was introduced in a number of other states, and underwent bar association, law revision commission and legislative study in still further states. In that process debate emerged, principally sparked by the study of Article 2A by the California Bar Association, California's nonuniform amendments to Article 2A, and articles appearing in a symposium on Article 2A published after its promulgation in the Alabama Law Review. The debate chiefly centered on whether Article 2A had struck the proper balance or was clear enough concerning the ability of a lessor to grant a security interest in its leasehold interest and in the residual, priority between a secured party and the lessee, and the lessor's remedy structure under Article 2A.

This debate over issues on which reasonable minds could and did differ began to affect the enactment effort for Article 2A in a deleterious manner. Consequently, the Standby Committee for Article 2A, composed predominantly of the former members of the drafting committee, reviewed the legislative actions and studies in the various states, and opened a dialogue with the principal proponents of the non-uniform amendments. Negotiations were conducted in conjunction with, and were facilitated by, a study of the uniform Article and the non-uniform Amendments by the New York Law Revision Commission. Ultimately, a consensus was reached, which has been approved by the membership of the Conference, the Permanent Editorial Board, and the Council of the Institute. Rapid and uniform enactment of Article 2A is expected as a result of the completed amendments. The Article 2A experience reaffirms the essential viability of the procedures of the Conference and the Institute for creating and updating uniform state law in the commercial law area.

Relationship of Article 2A to Other Articles: The Article on Sales provided as a useful point of reference for codifying the law of leases. Many of the provisions of that Article were carried over, changed to reflect differences in style, leasing terminology or lease practices. Thus, the official comments to those sections of Article 2 whose provisions were carried over are incorporated by reference in Article 2A, as well; further, any case law interpreting those provisions shall be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases. Any change in the sequence that has been made when carrying over a provision from Article 2 should be viewed as a matter of style, not substance. This is not to suggest that in other instances Article 2A did not also incorporate substantially revised provisions of Article 2, Article 9 or otherwise where the revision was driven by a concern over the substance; but for the lack of a mandate, the drafting committee might well have made the same or a similar change in the statutory analogue. Those sections in Article 2A include Sections 2A-104, 2A-105, 2A-106, 2A-108(2) and (4), 2A-109(2), 2A-208, 2A-214(2) and (3)(a), 2A-216, 2A-303, 2A-306, 2A-503, 2A-504(3)(b), 2A-506(2), and 2A-515. For lack of relevance or significance not all of the provisions of Article 2 were incorporated in Article 2A.

This codification was greatly influenced by the fundamental tenet of the common law as it had developed with respect to leases of goods: freedom of the parties to contract. Note that, like all other Articles of this Act, the principles of construction and interpretation contained in Article 1 are applicable throughout Article 2A (Section 2A-103(4)). These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care (Section 1-102(3)). Consistent with those principles no negative inference is to be drawn by the episodic use of the phrase “unless otherwise agreed” in certain provisions of Article 2A. Section 1-102(4). Indeed, the contrary is true, as the general rule in the Act, including this Article, is that the effect of the Act’s provisions may be varied by agreement. Section 1-102(3). This conclusion follows even where the statutory analogue contains the phrase and the correlative provision in Article 2A does not.

§ 25-2A-102. Scope.

This Article applies to any transaction, regardless of form, that creates a lease. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-102(1). Throughout this Article, unless otherwise stated, references to “Section” are to other sections of this Act.

Changes: Substantially revised.

Purposes:

This Article governs transactions as diverse as the lease of a hand tool to an individual for a few hours and the leveraged lease of a complex line of industrial equipment to a multi-national organization for a number of years.

To achieve that end it was necessary to provide that this Article applies to any transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an interest in goods (Section 2A-103(1)(j)) and goods is defined to include fixtures (Section 2A-103(1)(h)), application is limited to the extent the transaction relates to goods, including fixtures. Further, since the definition of lease does not include a sale (Section 2-106(1)) or retention or creation of a security interest (Section 1-201(37)), application is further limited; sales and security interests are governed by other Articles of this Act.

Finally, in recognition of the diversity of the transactions to be governed, the sophistication of many of the parties to these transactions, and the common law tradition as it applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, *Secured Transactions Under the Uniform Commercial Code,* § 29B.02[2] (1986). Thus, despite the extensive regulatory scheme established by this Article, the parties to a lease will be able to create private rules to govern their transaction. Sections 2A-103(4) and 1-102(3). However, there are special rules in this Article governing consumer leases, as well as other state and federal statutes, that may further limit freedom of contract with respect to consumer leases.

A court may apply this Article by analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods. *E.g.,* Hawkland, *The Impact of the Uniform Commercial Code on Equipment Leasing,* 1972 Ill. L.F. 446; Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code,* 39 Fordham L. Rev. 447 (1971). Whether such application would be appropriate for other bailments of personal property, gratuitous or for hire, should be determined by the facts of each case. *See Mieske v. Bartell Drug Co.,* 92 Wash.2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

Further, parties to a transaction creating a lease of personal property other than goods, or a bailment of personal property may provide by agreement that this Article applies. Upholding the parties' choice is consistent with the spirit of this Article.

Cross References:

Sections 1-102(3), 1-201(37), Article 2, esp. Section 2-106(1), and Sections 2A-103(1)(h), 2A-103(1)(j) and 2A-103(4).

Definitional Cross References:

"Lease". Section 2A-103(1)(j).

§ 25-2A-103. Definitions and index of definitions.

(1) In this Article unless the context otherwise requires:

(a) "Buyer in ordinary course of business" means a person who, in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes acquiring goods or documents of title under a preexisting contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(b) "Cancellation" occurs when either party puts an end to the lease contract for default by the other party.

(c) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "Conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed twenty-five thousand dollars ($25,000).

(f) "Fault" means wrongful act, omission, breach, or default.

(g) "Finance lease" means a lease with respect to which: (i) the lessor does not select, manufacture, or supply the goods; (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and (iii) one of the following occurs:
  (A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;
  (B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;
  (C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or
  (D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

(h) "Goods" means all things that are movable at the time of identification to the lease contract, or are fixtures (G.S. 25- 2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "Installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "Lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease. The term includes a motor vehicle operating agreement that is considered a lease under § 7701(h) of the Internal Revenue Code.

(k) "Lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(*l*) "Lease contract" means the total legal obligation that results from the lease agreement as affected by this Article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.

(m) "Leasehold interest" means the interest of the lessor or the lessee under a lease contract.

(n) "Lessee" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.

(o) "Lessee in ordinary course of business" means a person who, in good faith and without knowledge that the lease to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes acquiring goods or documents of title under a preexisting lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(p) "Lessor" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.

(q) "Lessor's residual interest" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.

(r) "Lien" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest.

(s) "Lot" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.

(t) "Merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease.

(u) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(v) "Purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.

(w) "Sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.

(x) "Supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease.

(y) "Supply contract" means a contract under which a lessor buys or leases goods to be leased.

(z) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Accessions". G.S. 25-2A-310(1).
"Construction mortgage". G.S. 25-2A-309(1)(d).
"Encumbrance". G.S. 25-2A-309(1)(e).
"Fixtures". G.S. 25-2A-309(1)(a).
"Fixture filing". G.S. 25-2A-309(1)(b).

"Purchase money lease". G.S. 25-2A-309(1)(c).

(3) The following definitions in other Articles apply to this Article:

"Account"	G.S. 25-9-102(a)(2).
"Between merchants"	G.S. 25-2-104(3).
"Buyer"	G.S. 25-2-103(1)(a).
"Chattel paper"	G.S. 25-9-102(a)(11).
"Consumer goods"	G.S. 25-9-102(a)(23).
"Document"	G.S. 25-9-102(a)(30).
"Entrusting"	G.S. 25-2-403(3).
"General intangible"	G.S. 25-9-102(a)(42).
"Instrument"	G.S. 25-9-102(a)(47).
"Merchant"	G.S. 25-2-104(1).
"Mortgage"	G.S. 25-9-102(a)(55).
"Pursuant to commitment"	G.S. 25-9-102(a)(68).
"Receipt"	G.S. 25-2-103(1)(c).
"Sale"	G.S. 25-2-106(1).
"Sale on approval"	G.S. 25-2-326.
"Sale or return"	G.S. 25-2-326.
"Seller"	G.S. 25-2-103(1)(d).

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1993, c. 463, s. 1; 1993 (Reg. Sess., 1994), c. 756, s. 1; 1995, c. 509, s. 21; 2000-169, s. 13; 2006-112, ss. 5, 38.)

OFFICIAL COMMENT

(a) "Buyer in ordinary course of business". Section 1-201(9).

(b) "Cancellation". Section 2-106(4). The effect of a cancellation is provided in Section 2A-505(1).

(c) "Commercial unit". Section 2-105(6).

(d) "Conforming". Section 2-106(2).

(e) "Consumer lease". New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A-106, 2A-108(2), 2A-108(4), 2A-109(2), 2A-221, 2A-309, 2A-406, 2A-407, 2A-504(3)(b), and 2A-516(3)(b).

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A-103(1)(j). Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes, present and future, and existing consumer protection decisions are unaffected by this Article. Section 2A-104(1)(c) and (2). Of course, Article 2A as state law also is subject to federal consumer protection law.

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered, and whether there should be a limitation by dollar amount and its amount is left up to the individual states.

This definition focuses on the parties as well as the transaction. If a lease is within this definition, the lessor must be regularly engaged in the business of leasing or selling, and the lessee must be an individual not an organization; note that a lease to two or more individuals having a common interest through marriage or the like is not excluded as a lease to an organization under Section 1-201(28). The lessee must take the interest primarily for a personal, family or household purpose. If required by the enacting state, total payments under the lease contract, excluding payments for options to renew or buy, cannot exceed the figure designated.

(f) "Fault". Section 1-201(16).

(g) "Finance Lease". New. This Article includes a subset of rules that applies only to finance leases. Sections 2A-209, 2A-211(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2) and 2A-517(1)(a) and (2).

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j). Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article.

A finance lease is the product of a three-party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. If a manufacturer's warranty carries through, the lessee may also look to that. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62-71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A-308(3)) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B had bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A-103(1)(j). In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) (A) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee's reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods (where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the phrase "in connection with" is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations and covenants, and upon the supplier or a manufacturer, or both, for warranties with respect to the goods, subsection (iii) requires that one of the following occur: (A) the lessee receive a copy of the supply contract before signing the lease contract; (B) the lessee's approval of the supply contract is a condition to the effectiveness of the lease contract; (C) the lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract; or (D) before signing the lease contract and except in a consumer lease, the lessee receive a writing identifying the supplier (unless the supplier was selected and required by the lessee) and the rights of the lessee under Section 2A-209, and advising the lessee a statement of promises and warranties is available from the supplier. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract. Moreover, where the lessor does not want the lessee to see the entire supply contract, including price information, the lessee may be provided with a separate statement of the terms of the supply contract relevant to the lessee; promises between the supplier and the lessor that do not affect the lessee need not be included. The statement can be a restatement of those terms or a copy of portions of the supply contract with the relevant terms clearly designated. Any implied warranties need not be designated, but a disclaimer or modification of remedy must be designated. A copy of any manufacturer's warranty is sufficient if that is the warranty provided. However, a copy of any Regulation M disclosure given pursuant to 12 C.F.R. G.S. 213.4(g) concerning warranties in itself is not sufficient since those disclosures need only briefly identify express warranties and need not include any disclaimer of warranty.

If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like), a lease that qualifies as a finance lease and is assigned by the lessor or the lessee to a third party does not lose its status as a finance lease under this Article. Finally, this Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case.

(h) "Goods". Section 9-105(1)(h). See Section 2A-103(3) for reference to the definition of "Account", "Chattel paper", "Document", "General intangibles" and "Instrument". See Section 2A-217 for determination of the time and manner of identification.

(i) "Installment lease contract". Section 2-612(1).

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A-309), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, *Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision*, 12 U.S.F. L.Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, *Personal Property Leasing: A Challenge*, 36 Bus.Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2-106(1)) nor a retention or creation of a security interest (Section 1-201(37)). Due to extensive litigation to distinguish true leases from security interests, an amendment to Section 1-201(37) has been promulgated with this Article to create a sharper distinction.

This section as well as Section 1-201(37) must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A-103(1)(h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A-103(3) and 2-106(1). Under pre-Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. *Da Rocha v. Macomber*, 330 Mass. 611, 614-15, 116 N.E.2d 139, 142 (1953). Under Section 1-201(37), as amended with the promulgation of this Article, the same result would follow. While the lessee is obligated to pay rent for the one- month term of the lease, one of the other four conditions of the second paragraph of Section 1-201(37) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, subparagraph (a) of Section 1-201(37) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, subparagraph (b) of Section 1-201(37) is not satisfied. Finally, there are no options; thus, subparagraphs (c) and (d) of Section 1-201(37) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre-Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. *Hervey v. Rhode Island Locomotive Works*, 93 U.S. 664, 672-73 (1876). Under this subsection, and Section 1-201(37), as amended with the inclusion of this Article in the Act, the same result would follow. The lessee's obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions have not been properly categorized by the courts in applying the 1978 and earlier Official Texts of Section 1-201(37). This subsection, together with Section 1-201(37), as amended with the promulgation of this Article, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from the first sentence of Section 1-201(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2-106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A-309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A-103(4) and 1-103.

(*l*) "Lease contract". This definition is derived from the definition of contract in Section 1-201(11). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) "Leasehold interest". New.

(n) "Lessee". New.

(o) "Lessee in ordinary course of business". Section 1-201(9).

(p) "Lessor". New.

(q) "Lessor's residual interest". New.

(r) "Lien". New. This term is used in Section 2A-307 (Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) "Lot". Section 2-105(5).

(t) "Merchant lessee". New. This term is used in Section 2A-511 (Merchant Lessee's Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. *E.g., Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322, 316 S.E.2d 788 (Ct. App. 1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people would differ as to the rate of discount to apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.

(v) "Purchase". Section 1-201(32). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1-201(32)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A-103(1)(r). Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1-201(32) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) "Sublease". New.

(x) "Supplier". New.

(y) "Supply contract". New.

(z) "Termination". Section 2-106(3). The effect of a termination is provided in Section 2A-505(2).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of

Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 5 and 38, effective October 1, 2006, in subsection (3), deleted "'Good faith'. G.S. 25-2-103(1)(b)." and made minor stylistic changes, and in subdivisions (1)(a) and (o), substituted "acquiring" for "receiving" and made minor stylistic changes.

CASE NOTES

Security Interest v. Lease. — An agreement purporting to lease equipment actually was a secured loan, where the lessee could purchase the equipment for $1 upon termination of the lease, the total monthly lease payments approximated the purchase price, the lessor was a financing company, the lessee not responsible for maintenance, insurance, taxes, and expenses, and the transaction was referred to as a loan in the parties' agreement. L.C. Williams Oil Co. v. NAFCO Capital Corp., 130 N.C. App. 286, 502 S.E.2d 415 (1998).

Suit Not Barred by Statute of Limitations for Breach of Lease. — Trial court erred in granting a lessee's summary judgment motion in a breach of a contract action filed by a lessor based on a three-year statute of limitations as the agreement was a lease under the North Carolina Uniform Commercial Code, specifically G.S. 25-2A-103(j), since it was originally structured with a four-year lease term; after the lease was modified by the bankruptcy court, the lessee was obligated to make 21 consecutive monthly payments beginning in August 1998 and the suit was not barred under the four-year statute of limitations for leases set forth in G.S. 25-2A-506(1). Finova Capital Corp. v. Beach Pharm. II, Ltd., 175 N.C. App. 184, 623 S.E.2d 289, 2005 N.C. App. LEXIS 2741 (2005).

Cited in McEwan v. Haver, 105 F. Supp. 2d 474 (E.D.N.C. 2000).

§ 25-2A-104. Leases subject to other law.

(1) A lease, although subject to this Article, is also subject to any applicable:
(a) certificate of title statute of this State (G.S. 20-50, G.S. 75A-32 et seq.);
(b) certificate of title statute of another jurisdiction (G.S. 25-2A-105); or
(c) consumer protection statute of this State, or final consumer protection decision of a court of this State existing on the effective date of this Article.

(2) In case of conflict between this Article, other than G.S. 2A-105, 2A-304(3), and 2A-305(3), and a statute or decision referred to in subsection (1) of this section, the statute or decision controls.

(3) Failure to comply with an applicable law has only the effect specified therein. (1993, c. 463, s. 1.)

OFFICAL COMMENT

Uniform Statutory Source: Sections 9-203(4) and 9-302(3)(b) and (c).

Changes: Substantially revised.

Purposes: — 1. This Article creates a comprehensive scheme for the regulation of transactions that create leases. Section 2A-102. Thus, the Article supersedes all prior legislation dealing with leases, except to the extent set forth in this Section.

2. Subsection (1) states the general rule that a lease, although governed by the scheme of this Article, also may be governed by certain other applicable laws. This may occur in the case of a consumer lease. Section 2A-103(1)(e). Those laws may be state statutes existing prior to enactment of Article 2A or passed afterward. In this case, it is desirable for this Article to specify which statute controls. Or the law may be a pre-existing consumer protection decision. This Article preserves such decisions. Or the law may be a statute of the United States. Such a law controls without any statement in this Article under applicable principles of preemption.

An illustration of a statute of the United States that governs consumer leases is the Consumer Leasing Act, 15 U.S.C. § 1667-1667(e) (1982) and its implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing personal property, and regulates the advertising of lease terms. An illustration of a state statute that governs consumer leases and which if adopted in the enacting state prevails over this Article is the Unif. Consumer Credit Code, which includes many provisions similar to those of the Consumer Leasing Act, e.g. Unif. Consumer Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as provisions in addition to those of the Consumer Leasing Act, e.g., Unif. Consumer Credit Code § 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default). Such statutes may define consumer lease so as to govern transactions within and without the definition of consumer lease under this Article.

3. Under subsection (2), subject to certain limited exclusions, in case of conflict a statute or a decision described in subsection (1) prevails over this Article. For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176 (1974), limiting self-help repossession, prevails over Section 2A-525(3). A consumer protection decision rendered after the effective date of this Article may supplement its provisions. For example, in relation to Article 9 a court might conclude that an acceleration clause may not be enforced against an individual debtor after late payments have been accepted unless a prior notice of default is given. To the extent the decision establishes a general principle applicable to transactions other than secured transactions, it may supplement Section 2A-502.

4. Consumer protection in lease transactions is primarily left to other law. However, several provisions of this Article do contain special rules that may not be varied by agreement in the case of a consumer lease. E.g., Sections 2A-106, 2A-108, and 2A-109(2). Were that not so, the ability of the parties to govern their relationship by agreement together with the position of the lessor in a consumer lease too often could result in a one-sided lease agreement.

5. In construing this provision the reference to statute should be deemed to include applicable regulations. A consumer protection decision is "final" on the effective date of this Article if it is not subject to appeal on that date or, if subject to appeal, is not later reversed on appeal. Of course, such a decision can be overruled by a later decision or superseded by a later statute.

Cross References: — Sections 2A-103(1)(e), 2A-106, 2A-108, 2A-109(2) and 2A-525(3).

Definitional Cross Reference: — "Lease". Section 2A-103(1)(j).

§ 25-2A-105. Territorial application of Article to goods covered by certificate of title.

Subject to the provisions of G.S. 25-2A-304(3) and G.S. 25-2A-305(3), with respect to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter until a new certificate of title is issued by another jurisdiction. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-103(2)(a) and (b).

Changes: Substantially revised. The provisions of the last sentence of Section 9-103(2)(b) have not been incorporated as it is superfluous in this context. The provisions of Section 9-103(2)(d) have not been incorporated because the problems dealt with are adequately addressed by this section and Sections 2A-304(3) and 305(3).

Purposes:

The new certificate referred to in (b) must be permanent, not temporary. Generally, the lessor or creditor whose interest is indicated on the most recently issued certificate of title will prevail over interests indicated on certificates issued previously by other jurisdictions. This provision reflects a policy that it is reasonable to require holders of interests in goods covered by a certificate of title to police the goods or risk losing their interests when a new certificate of title is issued by another jurisdiction.

Cross References:

Sections 2A-304(3), 2A-305(3), 9-103(2)(b) and 9-103(2)(d).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).

§ 25-2A-106. Limitation on power of parties to consumer lease to choose applicable law and judicial forum.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, that choice of law is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, that choice of forum is not enforceable. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Unif. Consumer Credit Code § 1.201(8), 7A U.L.A. 36 (1974).

Changes: Substantially revised.

Purposes:

There is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. As a result, this section invalidates these choice of law or forum clauses, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept, or the forum chosen is one that otherwise would have jurisdiction over the lessee.

Subsection (1) limits potentially abusive choice of law clauses in consumer leases. The 30-day rule in subsection (1) was suggested by Section 9-103(1)(c). This section has no effect on choice of law clauses in leases that are not consumer leases. Such clauses would be governed by other law.

Subsection (2) prevents enforcement of potentially abusive jurisdictional consent clauses in consumer leases. By using the term judicial forum, this section does not limit selection of a nonjudicial forum, such as arbitration. This section has no effect on choice of forum clauses in leases that are not consumer leases; such clauses are, as a matter of current law, "prima facie valid". The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972). Such clauses would be governed by other law, including the Model Choice of Forum Act (1968).

Cross Reference:

Section 9-103(1)(c).

Definitional Cross Reference:

"Consumer lease". Section 2A-103(1)(e).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Goods". Section 2A-103(1)(h).
"Party". Section 1-201(29).

Cross References. — For provision declaring as void as against public policy any provision in a contract to improve real property subjecting the parties to the laws of another state or subjecting the parties to litigation and arbitration in another state, see G.S. 22B-2. For provision that any forum selection provision in a contract entered into in North Carolina is void as against public policy, see G.S. 22B-3.

§ 25-2A-107. Waiver or renunciation of claim or right after default.

Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-107.

Changes: Revised to reflect leasing practices and terminology. This clause is used throughout the official comments to this Article to indicate the scope of change in the provisions of the Uniform Statutory Source included in the section; these changes range from one extreme, e.g., a significant difference in practice (a warranty as to merchantability is not implied in a finance lease (Section 2A-212)) to the other extreme, e.g., a modest difference in style or terminology (the transaction governed is a lease not a sale (Section 2A-203)).

Cross References:
Sections 2A203 and 2A-212.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Rights". Section 1-201(36).
"Signed". Section 1-201(39).
"Written". Section 1-201(46).

§ 25-2A-108. Unconscionability.

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made, the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under subsection (1) or (2) of this section, the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:
- (a) if the court finds unconscionability under subsection (1) or (2) of this section, the court shall award reasonable attorneys' fees to the lessee.
- (b) if the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he knew to be groundless, the court shall award reasonable attorneys' fees to the party against whom the claim is made.
- (c) in determining attorneys' fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) of this section is not controlling. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-302 and Unif. Consumer Credit Code §§ 5.108, 7A U.L.A. 167-69 (1974).

Changes: Subsection (1) is taken almost verbatim from the provisions of Section 2-302(1). Subsection (2) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (3), taken from the provisions of Section 2-302(2), has been expanded to cover unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167 (1974). The provision for the award of attorney's fees to consumers, subsection (4), covers unconscionability under subsection (1) as well as (2). Subsection (4) is modeled on the provisions of Unif. Consumer Credit Code § 5.108(6), 7A U.L.A. 169 (1974).

Purposes:
Subsections (1) and (3) of this section apply the concept of unconscionability reflected in the provisions of Section 2-302 to leases. See Dillman & Assocs. v. Capitol Leasing Co., 110 Ill.App.3d 335, 342, 442 N.E.2d 311, 316 (App.Ct. 1982). Subsection (3) omits the adjective "commercial" found in subsection 2-302(2) because subsection (3) is concerned with all leases and the relevant standard of conduct is determined by the context.

The balance of the section is modeled on the provisions of Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (2) recognizes that a consumer lease or a clause in a consumer lease may not itself be unconscionable but that the agreement would never have been entered into if unconscionable means had not been employed to induce the consumer to agree. To make a statement to induce the consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable. Subsection (2) also provides a consumer remedy for unconscionable conduct, such as using or threatening to use force or violence, in the collection of a claim arising from a lease contract. These provisions are not exclusive. The remedies of this section are in addition to remedies otherwise available for the same conduct under other law, for example, an action in tort for abusive debt collection or under another statute of this State for such conduct. The reference to appropriate relief in subsection (2) is intended to foster liberal administration of this remedy. Sections 2A-103(4) and 1-106(1).

Subsection (4) authorizes an award of reasonable attorney's fees if the court finds unconscionability with respect to a consumer lease under subsections (1) or (2). Provision is also made for recovery by the party against whom the claim was made if the court does not find unconscionability and does find that the consumer knew the action to be groundless. Further, subsection (4)(b) is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees.

Cross References:

Sections 1106(1), 2-302 and 2A-103(4).

Definitional Cross Reference:

"Action". Section 1-201(1).
"Consumer lease". Section 2A103(1)(e).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).

CASE NOTES

Forum Selection Clause. — Federal district court held that a forum selection clause was not contrary to North Carolina public policy as set forth in G.S. 22B-3 because that section applied only to contracts entered into in North Carolina and the contract at issue was entered into in Massachusetts. Price v. Leasecomm Corp., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 5467 (M.D.N.C. Mar. 31, 2004).

Federal district court held that a forum selection clause was not contrary to North Carolina public policy as set forth in G.S. 22B-10 where, although the agreement purported to waive plaintiff's right to a jury trial, even if this provision were unconscionable, the court would not have had to strike the entire forum selection clause in order to strike the jury waiver provision. Price v. Leasecomm Corp., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 5467 (M.D.N.C. Mar. 31, 2004).

Forum selection clause was conspicuous where, although the font used in the forum selection clause could have been made larger, the forum selection language was found in two places on the front page of an agreement, both times in bold print and underlined. Price v. Leasecomm Corp., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 5467 (M.D.N.C. Mar. 31, 2004).

§ 25-2A-109. Option to accelerate at will.

(1) A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import must be construed to mean that he has power to do so only if he in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under subsection (1) of this section is on the party who exercised the power; otherwise, the burden of establishing lack of good faith is on the party against whom the power has been exercised. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-208 and Unif. Consumer Credit Code § 5.109(2), 7A U.L.A. 171 (1974).

Purposes:

Subsection (1) reflects modest changes in style to the provisions of the first sentence of Section 1-208.

Subsection (2), however, reflects a significant change in the provisions of the second sentence of Section 1-208 by creating a new rule with respect to a consumer lease. A lease provision allowing acceleration at the will of the lessor or when the lessor deems itself insecure is of critical importance to the lessee. In a consumer lease it is a provision that is not usually agreed to by the parties but is usually mandated by the lessor. Therefore, where its invocation depends not on specific criteria but on the discretion of the lessor, its use should be regulated to prevent abuse. Subsection (1) imposes a duty of good faith upon its exercises. Subsection (2) shifts the burden of establishing good faith to the lessor in the case of a consumer lease, but not otherwise.

Cross Reference:
Section 1-208.

Definitional Cross Reference:
"Burden of establishing". Section 1-201(8).
"Consumer lease". Section 2A103(1)(e).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Party". Section 1-201(29).
"Term". Section 1-201(42).

PART 2.

Formation and Construction of Lease Contract.

§ 25-2A-201. Statute of frauds.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than one thousand dollars ($1,000); or

(b) there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1)(b) of this section, whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1)(b) of this section beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1) of this section, but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) of this section is:

(a) if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted;

(c) if there is other evidence of the parties' intent with regard to the lease term, the term so intended; or

(d) in the absence of evidence of the parties' intent, a reasonable lease term. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-201, 9-203(1) and 9-110.

Changes: This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the writing "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

Purposes:

The changes in this section conform the provisions of Section 2-201 to custom and usage in lease transactions. Section 2-201(2), stating a special rule between merchants, was not included in this section as the number of such transactions involving leases, as opposed to sales, was thought to be modest. Subsection (4) creates no exception for transactions where payment has been made and accepted. This represents a departure from the analogue, Section 2-201(3)(c). The rationale for the departure is grounded in the distinction between sales and leases. Unlike a buyer in a sales transaction, the lessee does not tender payment in full for goods delivered, but only payment of rent for one or more months. It was decided that, as a matter of policy, this act of payment is not a sufficient substitute for the required memorandum. Subsection (5) was needed to establish the criteria for supplying the lease term if it is omitted, as the lease contract may still be enforceable under subsection (4).

Cross References:

Sections 2-201, 9-110 and 9-203(1)(a).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreed". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Sale". Section 2-106(1).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

Legal Periodicals. — For article, "The Regulation of Contractual Change: A Guide to No Oral Modification Clauses for North Carolina Lawyers," see 81 N.C.L. Rev. 2239 (2003).

§ 25-2A-202. Final written expression: parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and
(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-202.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Course of dealing". Section 1-205.
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 25-2A-203. Seals inoperative.

The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-203.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Lease contract". Section 2A-103(1)(*l*).
"Writing". Section 1-201(46).

§ 25-2A-204. Formation in general.

(1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-204.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Term". Section 1-201(42).

§ 25-2A-205. Firm offers.

An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed three months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-205.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-206. Offer and acceptance in formation of lease contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-206(1)(a) and (2).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Lease contract". Section 2A-103(1)(*l*).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).

§ 25-2A-207: Repealed by Session Laws 2006-112, s. 6, effective October 1, 2006.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

§ 25-2A-208. Modification, rescission and waiver.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) of this section, it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-209.

Changes: Revised to reflect leasing practices and terminology, except that the provisions of subsection 2-209(3) were omitted.

Purposes:

Section 2-209(3) provides that "the requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions." This provision was not incorporated as it is unfair to allow an oral modification to make the entire lease contract unenforceable, e.g., if the modification takes it a few dollars over the dollar limit. At the same time, the problem could not be solved by providing that the lease contract would still be enforceable in its premodification state (if it then satisfied the statute of frauds) since in some cases that might be worse than no enforcement at all. Resolution of the issue is left to the courts based on the facts of each case.

Cross References:
Sections 2-201 and 2-209.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Between merchants". Section 2104(3).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Merchant". Section 2-104(1).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-209. Lessee under finance lease as beneficiary of supply contract.

(1) The benefit of a supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all defenses or claims arising therefrom.

(2) The extension of the benefit of a supplier's promises and of warranties to the lessee (G.S. 25-2A-209(1)) does not: (i) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (ii) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective between the supplier and the lessee unless, before the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the modification or rescission is effective between the supplier and the lessee, the lessor is deemed to have assumed, in addition to the obligations of the lessor to the lessee under the lease contract, promises of the supplier to the lessor and warranties that were so modified or rescinded as they existed and were available to the lessee before modification or rescission.

(4) In addition to the extension of the benefit of the supplier's promises and of warranties to the lessee under subsection (1) of this section, the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Changes: This section is modeled on Section 9-318, the Restatement (Second) of Contracts G.S. 302-315 (1981), and leasing practices. See Earman Oil Co. v. Burroughs Corp., 625 F.2d 1291, 1296-97 (5th Cir. 1980).

Purposes:

1. The function performed by the lessor in a finance lease is extremely limited. Section 2A-103(1)(g). The lessee looks to the supplier of the goods for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. That expectation is reflected in subsection (1), which is self-executing. As a matter of policy, the operation of this provision may not be excluded, modified or limited; however, an exclusion, modification, or limitation of any term of the supply contract or warranty, including any with respect to rights and remedies, and any defense or claim such as a statute of limitations, effective against the lessor as the acquiring party under the supply contract, is also effective against the lessee as the beneficiary designated under this provision. For example, the supplier is not precluded from excluding or modifying an express or implied warranty under a supply contract. Sections 2-312(2) and 2-316, or Section 2A-214. Further, the supplier is not precluded from limiting the rights and remedies of the lessor and from liquidating damages. Sections 2-718 and 2-719 or Sections 2A-503 and 2A-504. If the supply contract excludes or modifies warranties, limits remedies, or liquidates damages with respect to the lessor, such provisions are enforceable against the lessee as beneficiary. Thus, only selective discrimination against the beneficiaries designated under this section is precluded,

i.e., exclusion of the supplier's liability to the lessee with respect to warranties made to the lessor. This section does not affect the development of other law with respect to products liability.

2. Enforcement of this benefit is by action. Sections 2A-103(4) and 1-106(2).

3. The benefit extended by these provisions is not without a price, as this Article also provides in the case of a finance lease that is not a consumer lease that the lessee's promises to the lessor under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. Section 2A-407.

4. Subsection (2) limits the effect of subsection (1) on the supplier and the lessor by preserving, notwithstanding the transfer of the benefits of the supply contract to the lessee, all of the supplier's and the lessor's rights and obligations with respect to each other and others; it further absolves the lessee of any duties with respect to the supply contract that might have been inferred from the extension of the benefits thereof.

5. Subsections (2) and (3) also deal with difficult issues related to modification or rescission of the supply contract. Subsection (2) states a rule that determines the impact of the statutory extension of benefit contained in subsection (1) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-216 and 2-318, is not a modification of the supply contract by the parties. Thus, subsection (3) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (3) provides that a modification or rescission is not effective between the supplier and the lessee if, before the modification or rescission occurs, the supplier received notice that the lessee has entered into the finance lease. On the other hand, if the modification or rescission is effective, then to the extent of the modification or rescission of the benefit or warranty, the lessor by statutory dictate assumes an obligation to provide to the lessee that which the lessee would otherwise lose. For example, assume a reduction in an express warranty from four years to one year. No prejudice to the lessee may occur if the goods perform as agreed. If, however, there is a breach of the express warranty after one year and before four years pass, the lessor is liable. A remedy for any prejudice to the lessee because of the bifurcation of the lessee's recourse resulting from the action of the supplier and the lessor is left to resolution by the courts based on the facts of each case.

6. Subsection (4) makes it clear that the rights granted to the lessee by this section do not displace any rights the lessee otherwise may have against the supplier.

Cross References:

Sections 2A-103(1)(g), 2A-407 and 9-318.

Definitional Cross References:

"Action". Section 1-201(1).
"Finance lease". Section 2A-103(1)(g).
"Leasehold interest". Section 2A103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Supply contract". Section 2A103(1)(y).
"Term". Section 1-201(42).

§ 25-2A-210. Express warranties.

(1) Express warranties by the lessor are created as follows:

(a) any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise.

(b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description.

(c) any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee", or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313.

Changes: Revised to reflect leasing practices and terminology.

Purposes:

All of the express and implied warranties of the Article on Sales (Article 2) are included in this Article, revised to reflect the differences between a sale of goods and a lease of goods. Sections 2A-210 through 2A-216. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill.L.F. 446, 459-60. Many state and federal courts have reached the same conclusion.

Value of the goods, as used in subsection (2), includes rental value.

Cross References:

Article 2, esp. Section 2-313, and Sections 2A-210 through 2A-216.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Value". Section 1-201(44).

§ 25-2A-211. Warranties against interference and against infringement; lessee's obligation against infringement.

(1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement of the like that arises out of compliance with the specifications. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312.

Changes: This section is modeled on the provisions of Section 2-312, with modifications to reflect the limited interest transferred by a lease contract and the total interest transferred by a sale. Section 2-312(2), which is omitted here, is incorporated in Section 2A-214. The warranty of quiet possession was abolished with respect to sales of goods. Section 2-312 official comment 1. Section 2A-211(1) reinstates the warranty of quiet possession with respect to leases. Inherent in the nature of the limited interest transferred by the lease — the right to possession and use of the goods — is the need of the lessee for protection greater than that afforded to the buyer. Since the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee. Further, to the extent the market will allow, the lessor can attempt to pass on the anticipated additional cost to the lessee in the guise of higher rent.

Purposes:

General language was chosen for subsection (1) that expresses the essence of the lessee's expectation: with an exception for infringement and the like, no person holding a claim or interest that arose from an act or omission of the lessor will be able to interfere with the lessee's use and enjoyment of the goods for the lease term. Subsection (2), like other similar provisions in later sections, excludes the finance lessor from extending this warranty; with few exceptions (Sections 2A-210 and 2A-211(1)), the lessee under a finance lease is to look to the supplier for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. Subsections (2) and (3) are derived from Section 2-312(3). These subsections, as well as the analogue, should be construed so that applicable principles of law and equity supplement their provisions. Sections 2A-103(4) and 1-103.

Cross References:
Sections 2-312, 2-312(1), 2-312(2), 2-312 official comment 1, 2A-210, 2A-211(1) and 2A-214.

Definitional Cross References:
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-212. Implied warranty of merchantability.

(1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as:
- (a) pass without objection in the trade under the description in the lease agreement;
- (b) in the case of fungible goods, are of fair average quality within the description;
- (c) are fit for the ordinary purposes for which goods of that type are used;
- (d) run, within the variation permitted by the lease agreement, of even kind, quality, and quantity within each unit and among all units involved;
- (e) are adequately contained, packaged, and labeled as the lease agreement may require; and
- (f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314.

Changes: Revised to reflect leasing practices and terminology. E.g., Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 225, 541 P.2d 1184, 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease transactions).

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Course of dealing". Section 1-205.
"Finance lease". Section 2A-103(1)(g).
"Fungible". Section 1-201(17).
"Goods". Section 2A-103(1)(h).
"Lease Agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Usage of trade". Section 1-205.

§ 25-2A-213. Implied warranty of fitness for particular purpose.

Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315.

Changes: Revised to reflect leasing practices and terminology. E.g., All-States Leasing Co. v. Bass, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975) (implied warranty of fitness for a particular purpose (Article 2) extends to lease transactions).

Definitional Cross References:
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 25-2A-214. Exclusion or modification of warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of G.S. 25-2A-202 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3) of this section, to exclude or modify the implied warranty of merchantability, or any part of it, the language must mention "merchantability", by a writing, and be conspicuous. Subject to subsection (3) of this section, to exclude or modify any implied warranty of fitness, the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous, and states, for example, "There is no warranty that the goods will be fit for a particular purpose."

(3) Notwithstanding subsection (2) of this section, but subject to subsection (4) of this section:

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", or "with all faults", or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, if in writing and conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance, or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (G.S. 25-2A-211) or any part of it, the language must be specific, be by a writing, and be conspicuous, unless the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-316 and 2-312(2).

Changes: Subsection (2) requires that a disclaimer of the warranty of merchantability be conspicuous and in writing as is the case for a disclaimer of the warranty of fitness; this is contrary to the rule stated in Section 2-316(2) with respect to the disclaimer of the warranty of merchantability. This section also provides that to exclude or modify the implied warranty of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous. There are, however, exceptions to the rule. E.g., course of dealing, course of performance, or usage of trade may exclude or modify an implied warranty. Section 2A-214(3)(c). The analogue of Section 2-312(2) has been moved to subsection (4) of this section for a more unified treatment of disclaimers; there is no policy with respect to leases of goods that would justify continuing certain distinctions found in the Article on Sales (Article 2) regarding the treatment of the disclaimer of various warranties. Compare Sections 2-312(2) and 2-316(2). Finally, the example of a disclaimer of the implied warranty of fitness stated in subsection (2) differs from the analogue stated in Section 2-316(2); this example should promote a better understanding of the effect of the disclaimer.

Purposes:

These changes were made to reflect leasing practices. E.g., FMC Finance Corp. v. Murphree, 632 F.2d 413, 418 (5th Cir. 1980) (disclaimer of implied warranty under lease transactions must be conspicuous and in writing). The omission of the provisions of Section 2-316(4) was not substantive. Sections 2A-503 and 2A-504.

Cross References:

Article 2, esp. Sections 2-312(2) and 2-316, and Sections 2A-503 and 2A-504.

Definitional Cross References:

"Conspicuous". Section 1-201(10).
"Course of dealing". Section 1-205.
"Fault". Section 2A-103(1)(f).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 25-2A-215. Cumulation and conflict of warranties express or implied.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) a sample from an existing bulk displaces inconsistent general language of description.

(c) express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317.

Definitional Cross Reference:

"Party". Section 1-201(29).

§ 25-2A-216. Third-party beneficiaries of express and implied warranties.

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who is in the family or household of the lessee or who is a guest in the lessee's home if it is reasonable to expect that such person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against any beneficiary designated under this section. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318.

Changes: The provisions of Section 2-318 have been included in this section, modified in two respects: first, to reflect leasing practice, including the special practices of the lessor under a finance lease; second, to reflect and thus codify elements of the official comment to Section 2-318 with respect to the effect of disclaimers and limitations of remedies against third parties.

Purposes:

Alternative A is based on the 1962 version of Section 2-318 and is least favorable to the injured person as the doctrine of privity imposed by other law is abrogated to only a limited extent. Alternatives B and C are based on later additions to Section 2-318 and are more favorable to the injured person. In determining which alternative to select, the state legislature should consider making its choice parallel to the choice it made with respect to Section 2-318, as interpreted by the courts.

The last sentence of each of Alternatives A, B and C does not preclude the lessor from excluding or modifying an express or implied warranty under a lease. Section 2A-214. Further, that sentence does not preclude the lessor from limiting the rights and remedies of the lessee and from liquidating damages. Sections 2A-503 and 2A-504. If the lease excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessee, such provisions are enforceable against the beneficiaries designated under this section. However, this last sentence forbids selective discrimination against the beneficiaries designated under this section, i.e., exclusion of the lessor's liability to the beneficiaries with respect to warranties made by the lessor to the lessee.

Other law, including the Article on Sales (Article 2), may apply in determining the extent to which a warranty to or for the benefit of the lessor extends to the lessee and third parties. This is in part a function of whether the lessor has bought or leased the goods.

This Article does not purport to change the development of the relationship of the common law, with respect to products liability, including strict liability in tort (as restated in Restatement (Second) of Torts, G.S. 402A (1965)), to the provisions of this Act. Compare Cline v. Prowler Indus. of Maryland, 418 A.2d 968 (Del.1980) and Hawkins Constr. Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643 (1973) with Dippel v. Sciano, 37 Wis.2d 443, 155 N.W.2d 55 (1967).

Cross References:

Article 2, esp. Section 2-318, and Sections 2A-214, 2A-503 and 2A-504.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 25-2A-217. Identification.

Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) when the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) when the goods are shipped, marked, or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) when the young are conceived, if the lease contract is for a lease of unborn young of animals. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-218, is derived from the provisions of Section 2-501, with changes to reflect lease terminology; however, this section omits as irrelevant to leasing practice the treatment of special property.

Purposes:

With respect to subsection (b) there is a certain amount of ambiguity in the reference to when goods are designated, e.g., when the lessor is both selling and leasing goods to the same lessee/buyer and has marked goods for delivery but has not distinguished between those related to the lease contract and those related to the sales contract. As in Section 2-501(1)(b), this issue has been left to be resolved by the courts, case by case.

Cross References:

Sections 2-501 and 2A-218.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).

§ 25-2A-218. Insurance and proceeds.

(1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under subsections (1) and (2) of this section, the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-217, is derived from the provisions of Section 2-501, with changes and additions to reflect leasing practices and terminology.

Purposes:

Subsection (2) states a rule allowing substitution of goods by the lessor under certain circumstances, until default or insolvency of the lessor, or until notification to the lessee that identification is final. Subsection (3) states a rule regarding the lessor's insurable interest that, by virtue of the difference between a sale and a lease, necessarily is different from the rule stated in Section 2-501(2) regarding the seller's insurable interest. For this purpose the option to buy shall be deemed to have been exercised by the lessee when the resulting sale is closed, not when the lessee gives notice to the lessor. Further, subsection (5) is new and reflects the common practice of shifting the responsibility and cost of insuring the goods between the parties to the lease transaction.

Cross References:

Sections 2-501, 2-501(2) and 2A-217.

Definitional Cross References:

"Agreement". Section 1-102(3).
"Buying". Section 2A-103(1)(a).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).

§ 25-2A-219. Risk of loss.

(1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this Article on the effect of default on risk of loss (G.S. 25-2A-220), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) if the lease contract requires or authorizes the goods to be shipped by carrier (i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but (ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery.

(b) if the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods.

(c) in any case not within subdivision (a) or (b) of this section, the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-509(1) through (3).

Changes: Subsection (1) is new. The introduction to subsection (2) is new, but subparagraph (a) incorporates the provisions of Section 2-509(1); subparagraph (b) incorporates the provisions of Section 2-509(2) only in part, reflecting current practice in lease transactions.

Purposes:
Subsection (1) states rules related to retention or passage of risk of loss consistent with current practice in lease transactions. The provisions of subsection (4) of Section 2-509 are not incorporated as they are not necessary. This section does not deal with responsibility for loss caused by the wrongful act of either the lessor or the lessee.

Cross References:
Sections 2-509(1), 2-509(2) and 2-509(4).

Definitional Cross References:
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-220. Effect of default on risk of loss.

(1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) if a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance.

(b) if the lessee rightfully revokes acceptance, he, to the extent of any deficiency in his effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510.

Changes: Revised to reflect leasing practices and terminology. The rule in Section (1)(b) does not allow the lessee under a finance lease to treat the risk of loss as having remained with the supplier from the beginning. This is appropriate given the limited circumstances under which the lessee under a finance lease is allowed to revoke acceptance. Section 2A-517 and Section 2A-516 official comment.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-221. Casualty to identified goods.

If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor, or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or G.S. 25-2A-219, then:

(a) if the loss is total, the lease contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613.

Changes: Revised to reflect leasing practices and terminology.

Purpose:
Due to the vagaries of determining the amount of due allowance (Section 2-613(b)), no attempt was made in subsection (b) to treat a problem unique to lease contracts and installment sales contracts: determining how to recapture the allowance, e.g., application to the first or last rent payments or allocation, pro rata, to all rent payments.

Cross References:
Section 2-613.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A103(1)(e).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-193(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

PART 3.

EFFECT OF LEASE CONTRACT.

§ 25-2A-301. Enforceability of lease contract.

Except as otherwise provided in this Article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods, and against creditors of the parties. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201.

Changes: The first sentence of Section 9-201 was incorporated, modified to reflect leasing terminology. The second sentence of Section 9-201 was eliminated as not relevant to leasing practices.

Purposes:
1. This section establishes a general rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201. Enforceability is

also a function of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1). Section 2A-103(4).

2. The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Section 2A-309. Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37). Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing-Leveraged Leasing 681, 744-46 (2d ed. 1980).

3. Hypothetical: (a) In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a hypothetical. Assume that on February 1 A, a manufacturer of combines and other farm equipment, leased a fleet of six combines to B, a corporation engaged in the business of farming, for a 12 month term. Under the lease agreement between A and B, A agreed to defer B's payment of the first two months' rent to April 1. On March 1 B recognized that it would need only four combines and thus subleased two combines to C for an 11 month term.

(b) This hypothetical raises a number of issues that are answered by the sections contained in this part. Since lease is defined to include sublease (Section 2A-103(1)(j) and (w)), this section provides that the prime lease between A and B and the sublease between B and C are enforceable in accordance with their terms, except as otherwise provided in this Article; that exception, in this case, is one of considerable scope.

(c) The separation of ownership, which is in A, and possession, which is in B with respect to four combines and which is in C with respect to two combines, is not relevant. Section 2A-302. A's interest in the six combines cannot be challenged simply because A parted with possession to B, who in turn parted with possession of some of the combines to C. Yet it is important to note that by the terms of Section 2A-302 this conclusion is subject to change if otherwise provided in this Article.

(d) B's entering the sublease with C raises an issue that is treated by this part. In a dispute over the leased combines A may challenge B's right to sublease. The rule is permissive as to transfers of interests under a lease contract, including subleases. Section 2A-303(2). However, the rule has two significant qualifications. If the prime lease contract between A and B prohibits B from subleasing the combines, or makes such a sublease an event of default, Section 2A-303(2) applies; thus, while B's interest under the prime lease may not be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Absent a prohibition or default provision in the prime lease contract A might be able to argue that the sublease to C materially increases A's risk; thus, while B's interest under the prime lease may be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Section 2A-303(5)(b)(ii).

(e) Resolution of this issue is also a function of the section dealing with the sublease of goods by a prime lessee (Section 2A-305). Subsection (1) of Section 2A-305, which is subject to the rules of Section 2A-303 stated above, provides that C takes subject to the interest of A under the prime lease between A and B. However, there are two exceptions. First, if B is a merchant (Sections 2A-103(3) and 2-104(1)) dealing in goods of that kind and C is a sublessee in the ordinary course of business (Sections 2A-103(1)(o) and 2A-103(1)(n)), C takes free of the prime lease between A and B. Second, if B has rejected the six combines under the prime lease with A, and B disposes of the goods by sublease to C, C takes free of the prime lease if C can establish good faith. Section 2A-511(4).

(f) If the facts of this hypothetical are expanded and we assume that the prime lease obligated B to maintain the combines, an additional issue may be presented. Prior to entering the sublease, B, in satisfaction of its maintenance covenant, brought the two combines that it desired to sublease to a local independent dealer of A's. The dealer did the requested work for B. C inspected the combines on the dealer's lot after the work was completed. C signed the sublease with B two days later. C, however, was prevented from taking delivery of the two combines as B refused to pay the dealer's invoice for the repairs. The dealer furnished the repair service to B in the ordinary course of the dealer's business. If under applicable law the dealer has a lien on repaired goods in the dealer's possession, the dealer's lien will take priority over B's and C's interests, and also should take priority over A's interest, depending upon the terms of the lease contract and the applicable law. Section 2A-306.

(g) Now assume that C is in financial straits and one of C's creditors obtains a judgment against C. If the creditor levies on C's subleasehold interest in the two combines, who will prevail? Unless the levying creditor also holds a lien covered by Section 2A-306, discussed above, the judgment creditor will take its interest subject to B's rights under the sublease and A's rights under the prime lease. Section 2A-307(1). The hypothetical becomes more complicated if we assume that B is in financial straits and B's creditor holds the judgment. Here the judgment creditor takes subject to the sublease unless the lien attached to the two combines before the sublease contract became enforceable. Section 2A-307(2)(a). However, B's judgment creditor cannot prime A's interest in the goods because, with respect to A, the judgment creditor is a creditor of B in its capacity as lessee under the prime lease between A and B. Thus, here the judgment creditor's interest is subject to the lease between A and B. Section 2A-307(1).

(h) Finally, assume that on April 1 B is unable to pay A the deferred rent then due under the prime lease, but that C is current in its payments under the sublease from B. What effect will B's default under the prime lease between A and B have on C's rights under the sublease between B and C? Section 2A-301 provides that a lease contract is effective against the creditors of either party. Since a lease contract includes a sublease contract (Section 2A-103(1)(l)), the sublease contract between B and C arguably could be enforceable against A, a prime lessor who has extended unsecured credit to B the prime lessee/sublessor, if the sublease contract meets the requirements of Section 2A-201. However, the rule stated in Section 2A-301 is subject to other provisions in this Article. Under Section 2A-305, C, as sublessee, would take subject to the prime lease contract in most cases. Thus, B's default under the prime lease will in most cases lead to A's recovery of the goods from C. Section 2A-523. A and C could provide otherwise by agreement. Section 2A-311. C's recourse will be to assert a claim for damages against B. Sections 2A-211(1) and 2A-508.

4. Relationship Between Sections:

(a) As the analysis of the hypothetical demonstrates, Part 3 of the Article focuses on issues that relate to the enforceability of the lease contract (Sections 2A-301, 2A-302 and 2A-303) and to the priority of various claims to the goods subject to the lease contract (Sections 2A-304, 2A-305, 2A-306, 2A-307, 2A-308, 2A-309, 2A-310, and 2A-311).

(b) This section states a general rule of enforceability, which is subject to specific rules to the contrary stated elsewhere in the Article. Section 2A-302 negates any notion that the separation of title and possession is fraudulent as a rule of law. Finally, Section 2A-303 states rules with respect to the transfer of the lessor's interest (as well as the residual interest in the goods) or the lessee's interest under the lease contract. Qualifications are imposed as a function of various issues, including whether the transfer is the creation or enforcement of a security interest or one that is material to the other party to the lease contract. In addition, a system of rules is created to deal with the rights and duties among assignor, assignee and the other party to the lease contract.

(c) Sections 2A-304 and 2A-305 are twins that deal with good faith transferees of goods subject to the lease contract. Section 2A-304 creates a set of rules with respect to transfers by the lessor of goods subject to a lease contract; the transferee considered is a subsequent lessee of the goods. The priority dispute covered here is between the subsequent lessee and the original lessee of the goods (or persons claiming through the original lessee). Section 2A-305 creates a set of rules with respect to transfers by the lessee of goods subject to a lease contract; the transferees considered are buyers of the goods or sublessees of the goods. The priority dispute covered here is between the transferee and the lessor of the goods (or persons claiming through the lessor).

(d) Section 2A-306 creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

(e) Section 2A-308 creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the buyer-lessor can establish that he or she bought for value and in good faith.

(f) Sections 2A-309 and 2A-310 create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

(g) Finally, Section 2A-311 allows parties to alter the statutory priorities by agreement.

Cross References:

Article 1, especially Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(*l*), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(2), 2A-303(5), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-311, 2A-508, 2A-511(4), 2A-523, Article 9, especially Sections 9-201 and 9-408.

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).

"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Purchaser". Section 1-201(33).
"Term". Section 1-201(42).

§ 25-2A-302. Title to and possession of goods.

Except as otherwise provided in this Article, each provision of this Article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202.

Changes: Section 9-202 was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.

Purposes:
The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So.2d 1151 (Fla.Dist.Ct.App.1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308.

Cross References:
Sections 2A-301, 2A-308 and 9-202.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

CASE NOTES

Cited in Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

§ 25-2A-303. Alienability of party's interest under lease contract or of lessor's residual interest in goods; delegation of performance; transfer of rights.

(1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to Article 9 of this Chapter, Secured Transactions, by reason of G.S. 25-9-109(a)(3).

(2) Except as provided in subsection (3) of this section and G.S. 25-9-407, a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation, or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods; or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (4) of this section, but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or

materially increases the burden or risk imposed on, the other party to the lease contract within the purview of subsection (4) of this section.

(4) Subject to subsection (3) of this section and G.S. 25-9-407:

(a) if a transfer is made which is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in G.S. 25-2A-501(2);

(b) if paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(5) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(6) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(7) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous. (1993, c. 463, s. 1; 2000-169, s. 14.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Uniform Statutory Source: Sections 2-210 and 9-311.

Changes: The provisions of Sections 2-210 and 9-311 were incorporated in this section, with substantial modifications to reflect leasing terminology and practice and to harmonize the principles of the respective provisions, i.e., limitations on delegation of performance on the one hand and alienability of rights on the other. In addition, unlike Section 2-210 which deals only with voluntary transfers, this section deals with involuntary as well as voluntary transfers. Moreover, the principle of Section 9-318(4) denying effectiveness to contractual terms prohibiting assignments of receivables due and to become due also is implemented.

Purposes:

1. Subsection (2) states a rule, consistent with Section 9-401(b), that voluntary and involuntary transfers of an interest of a party under the lease contract or of the lessor's residual interest, including by way of the creation or enforcement of a security interest, are effective, notwithstanding a provision in the lease agreement prohibiting the transfer or making the transfer an event of default. Although the transfers are effective, the provision in the lease agreement is nevertheless enforceable, but only as provided in subsection (4). Under subsection (4) the prejudiced party is limited to the remedies on "default under the lease contract" in this Article and, except as limited by this Article, as provided in the lease agreement, if the transfer has been made an event of default. Section 2A-501(2). Usually, there will be a specific provision to this effect or a general provision making a breach of a covenant an event of default. In those cases where the transfer is prohibited, but not made an event of default, the prejudiced party may recover damages; or, if the damage remedy would be ineffective adequately to protect that party, the court can order cancellation of the lease contract or enjoin the transfer. This rule that such

provisions generally are enforceable is subject to subsection (3) and Section 9-407, which make such provisions unenforceable in certain instances.

2. Under Section 9-407, a provision in a lease agreement which prohibits the creation or enforcement of a security interest, including sales of lease contracts subject to Article 9 (Section 9-109(a)(3)), or makes it an event of default is generally not enforceable, reflecting the policy of Section 9-406 and former Section 9-318(4).

3. Subsection (3) is based upon Section 2-210(2) and Section 9-406. It makes unenforceable a prohibition against transfers of certain rights to payment or a provision making the transfer an event of default. It also provides that such transfers do not materially impair the prospect of obtaining return performance by, materially change the duty of, or materially increase the burden or risk imposed on, the other party to the lease contract so as to give rise to the rights and remedies stated in subsection (4). Accordingly, a transfer of a right to payment cannot be prohibited or made an event of default, or be one that materially impairs performance, changes duties or increases risk, if the right is already due or will become due without further performance being required by the party to receive payment. Thus, a lessor can transfer the right to future payments under the lease contract, including by way of a grant of a security interest, and the transfer will not give rise to the rights and remedies stated in subsection (4) if the lessor has no remaining performance under the lease contract. The mere fact that the lessor is obligated to allow the lessee to remain in possession and to use the goods as long as the lessee is not in default does not mean that there is remaining performance on the part of the lessor. Likewise, the fact that the lessor has potential liability under a "non-operating" lease contract for breaches of warranty does not mean that there is remaining performance. In contrast, the lessor would have remaining performance under a lease contract requiring the lessor to regularly maintain and service the goods or to provide "upgrades" of the equipment on a periodic basis in order to avoid obsolescence. The basic distinction is between a mere potential duty to respond which is not remaining performance, and an affirmative duty to render stipulated performance. Although the distinction may be difficult to draw in some cases, it is instructive to focus on the difference between "operating" and "non-operating" leases as generally understood in the marketplace. Even if there is remaining performance under a lease contract, a transfer for security of a right to payment that is made an event of default or that is in violation of a prohibition against transfer does not give rise to the rights and remedies under subsection (4) if it does not constitute an actual delegation of a material performance under Section 9-407.

4. The application of either the rule of Section 9-407 or the rule of subsection (3) to the grant by the lessor of a security interest in the lessor's right to future payment under the lease contract may produce the same result. Both provisions generally protect security transfers by the lessor in particular because the creation by the lessor of a security interest or the enforcement of that interest generally will not prejudice the lessee's rights if it does not result in a delegation of the lessor's duties. To the contrary, the receipt of loan proceeds or relief from the enforcement of an antecedent debt normally should enhance the lessor's ability to perform its duties under the lease contract. Nevertheless, there are circumstances where relief might be justified. For example, if ownership of the goods is transferred pursuant to enforcement of a security interest to a party whose ownership would prevent the lessee from continuing to possess the goods, relief might be warranted. See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft in the United States based on the citizenship or corporate qualification of the registrant.

5. Relief on the ground of material prejudice when the lease agreement does not prohibit the transfer or make it an event of default should be afforded only in extreme circumstances, considering the fact that the party asserting material prejudice did not insist upon a provision in the lease agreement that would protect against such a transfer.

6. Subsection (4) implements the rule of subsection (2). Subsection (2) provides that, even though a transfer is effective, a provision in the lease agreement prohibiting it or making it an event of default may be enforceable as provided in subsection (4). See Brummond v. First National Bank of Clovis, 656 P.2d 884, 35 U.C.C. Rep. Serv. (Callaghan) 1311 (N. Mex. 1983), stating the analogous rule for Section 9-311. If the transfer prohibited by the lease agreement is made an event of default, then, under subsection (4)(a), unless the default is waived or there is an agreement otherwise, the aggrieved party has the rights and remedies referred to in Section 2A-501(2), viz. those in this Article and, except as limited in the Article, those provided in the lease agreement. In the unlikely circumstance that the lease agreement prohibits the transfer without making a violation of the prohibition an event of default or, even if there is no prohibition against the transfer, and the transfer is one that materially impairs performance, changes duties, or increases risk (for example, a sublease or assignment to a party using the goods improperly or for an illegal purpose), then subsection (4)(b) is applicable. In that circumstance, unless the party aggrieved by the transfer has otherwise agreed in

the lease contract, such as by assenting to a particular transfer or to transfers in general, or agrees in some other manner, the aggrieved party has the right to recover damages from the transferor and a court may, in appropriate circumstances, grant other relief, such as cancellation of the lease contract or an injunction against the transfer.

7. If a transfer gives rise to the rights and remedies provided in subsection (4), the transferee as an alternative may propose, and the other party may accept, adequate cure or compensation for past defaults and adequate assurance of future due performance under the lease contract. Subsection (4) does not preclude any other relief that may be available to a party to the lease contract aggrieved by a transfer subject to an enforceable prohibition, such as an action for interference with contractual relations.

8. Subsection (7) requires that a provision in a consumer lease prohibiting a transfer, or making it an event of default, must be specific, written and conspicuous. See Section 1-201(10). This assists in protecting a consumer lessee against surprise assertions of default.

9. Subsection (5) is taken almost verbatim from the provisions of Section 2-210(5). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests. Security interest is defined to include "any interest of a buyer of . . . chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-102. Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

Cross References:

Sections 1-201(11), 1-201(37), 2-210, 2A-401, 9-102(1)(b), 9-104(f), 9-105(1)(a), 9-206, and 9-318.

Definitional Cross References:

"Agreed" and "Agreement". Section 1-201(3).
"Conspicuous". Section 1-201(10).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-304. Subsequent lease of goods by lessor.

(1) Subject to G.S. 25-2A-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) of this section and G.S. 25-2A-527(4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. If goods have been delivered under a transaction of purchase, the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;
(b) the delivery was in exchange for a check which is later dishonored;
(c) it was agreed that the transaction was to be a "cash sale"; or
(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee of that lessor before the interest of the subsequent lessee became enforceable against that lessor obtains, to the extent of the leasehold interest transferred, all of that lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a

statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes:

1. This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303, which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

2. This section must also be read in conjunction with Section 2-403. This section and Section 2A-305 are derived from Section 2-403, which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)), a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403, first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v).

3. There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) as L is not a buyer in the ordinary course of business. Section 1-201(9). Further, this transaction is not governed by Section 2A-304(2) as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) as B is not M's lessor. Section 2A-307(2) resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103. See, e.g., Restatement (Second) of Torts G.S. 222A — 243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12). Section 2A-307(2) provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q).

4. Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

5. Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

6. The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entrustee and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entrustee's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entrustee. Thus, the lessor entrustee retains the residual interest in the goods. Section 2A-103(1)(q). However, entrustment by the existing lessee must have

occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is defined in Section 2-403(3) and that definition applies here. Section 2A-103(3).

7. Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403, the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2). The better rule is that the certificate of title statutes are in harmony with Section 2-403 and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928, (Miss.1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J.Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References:

Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Purchase". Section 2A-103(1)(v).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-305. Sale or sublease of goods by lessee.

(1) Subject to the provisions of G.S. 25-2A-303, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in subsection (2) of this section and G.S. 25-2A-511(4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease, the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;
(b) the delivery was in exchange for a check which is later dishonored; or
(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute. (1993, c. 463, s. 1; 1995, c. 509, s. 22.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes:

This section, a companion to Section 2A-304, states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1). Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir. 1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D.Mass. 1983). Unlike Section 2A-304(2), this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 official comment.

Cross References:

Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Sublease". Section 2A-103(1)(w).
"Value". Section 1-201(44).

§ 25-2A-306. Priority of certain liens arising by operation of law.

If a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this Article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310.

Changes: The approach reflected in the provisions of Section 9-310 was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.

Purposes:

This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.

Cross Reference:

Section 9-310.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Person". Section 1-201(30).

§ 25-2A-307. Priority of liens arising by attachment or levy on, security interests in, and other claims to goods.

(1) Except as otherwise provided in G.S. 25-2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsection (3) of this section and in G.S. 25-2A-306 and G.S. 25-2A-308, a creditor of a lessor takes subject to the lease contract unless the creditor holds a lien that attached to the goods before the lease contract became enforceable.

(3) Except as otherwise provided in G.S. 25-9-317, 25-9-321, and 25-9-323, a lessee takes a leasehold interest subject to a security interest held by a creditor of the lessor. (1993, c. 463, s. 1; 2000-169, s. 15.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Uniform Statutory Source: None for subsection (1). Subsection (2) is derived from Section 9-301, and subsections (3) and (4) are derived from Section 9-307(1) and (3), respectively.

Changes: The provisions of Sections 9-301 and 9-307(1) and (3) were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.

Purposes:

1. Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) includes sublessee. Therefore, this subsection not only covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 official comment 3(g). Further, by using the term creditor (Section 1-201(12)), this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4).

2. Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 official comment 3(g). Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

3. To take priority over the lease contract, and the interests derived therefrom, the creditor must come within the exception stated in subsection (2) or within one of the provisions of Article 9 mentioned in subsection (3). Subsection (2) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. Subsection (3) provides that a lessee takes its leasehold interest subject to a security interest except as otherwise provided in Sections 9-317, 9-321, or 9-323.

4. The rules of this section operate in favor of whichever party to the lease contract may enforce it, even if one party perhaps may not, e.g., under Section 2A-201(1)(b).

Cross References:

Sections 1-201(12), 1-201(25), 1-201(37), 1-201(44), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-201(1)(b), 2A-301 official comment 3(g), Article 9, especially Sections 9-301, 9-307(1) and 9-307(3).

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Knowledge" and "Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Party". Section 1-201(29).
"Pursuant to commitment". Section 2A-103(3).
"Security interest". Section 1-201(37).

§ 25-2A-308. Special rights of creditors.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor

for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this Article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a preexisting claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart from this Article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b).

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes:

Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract between the buyer as lessor and the seller as lessee. Notwithstanding any statute or rule of law that would treat such retention as fraud, whether per se, prima facie, or otherwise, the retention is not fraudulent if the buyer bought for value (Section 1-201(44)) and in good faith (Sections 1-201(19) and 2-103(1)(b)). Section 2A-103(3) and (4). This provision overrides Section 2-402(2) to the extent it would otherwise apply to a sale-leaseback transaction.

Cross References:

Sections 1-201(19), 1-201(44), 2-402(2) and 2A-103(4).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).
"Contract". Section 1-201(11).
"Creditor". Section 1-201(12).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Seller". Section 2-103(1)(d).
"Value". Section 1-201(44).

§ 25-2A-309. Lessor's and lessee's rights when goods become fixtures.

(1) In this section:

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) a "fixture filing" is the filing, in the office where a record of a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of G.S. 25-9-502(a) and (b);

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this Article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this Article of ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within 10 days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures, the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding subsection (4)(a) of this section but otherwise subject to subsections (4) and (5) of this section, the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures, including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (i) on default, expiration, termination, or cancellation of the lease agreement but subject to the lease agreement and this Article, or (ii) if necessary to enforce other rights and remedies of the lessor or lessee under this Article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but the lessor or lessee must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the Article on Secured Transactions (Article 9). (1993, c. 463, s. 1; 2000-169, s. 16.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes:

1. While Section 9-313 provided a model for this section, certain provisions were substantially revised.

2. Section 2A-309(1)(c), which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

3. Section 2A-309(4), which states one of several priority rules found in this section, deletes reference to office machines and the like (Section 9-313(4)(c)) as well as certain liens (Section 9-313(4)(d)). However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

4. The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) automatic subordination of the security interest in fixtures. Note that, for the purpose of this section, where the interest of an encumbrancer or owner of the real estate is paramount to the intent of the lessor, the latter term includes the residual interest of the lessor.

5. The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

6. Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9 must be interpreted permissively to give effect to this mechanism as it implicitly expands the scope of Article 9 so that its filing provisions apply to transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) for the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37). Given the lack of litigation with respect to the mech-

anism created for consignment sales, this new mechanism should prove effective.

Cross References:

Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, especially Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A103(1)(e).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Mortgage". Section 9-105(1)(j).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

§ 25-2A-310. Lessor's and lessee's rights when goods become accessions.

(1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in subsection (4) of this section.

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in subsection (4) of this section but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or (3) of this section is subordinate to the interest of:

(a) a buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) of this section, a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may:

(a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this Article; or

(b) if necessary to enforce his other rights and remedies under this Article, remove the goods from the whole, free and clear of all interests in the whole, but he must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes:
Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8).

Neither this section nor Section 9-314 governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References:
Sections 2A309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4).

Definitional Cross References:
"Agreed". Section 1-201(3).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Cancellation". Section 2A-103(1)(b).
"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Holder". Section 1-201(20).
"Knowledge". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

PART 4.

PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED, AND EXCUSED.

§ 25-2A-401. Insecurity: adequate assurance of performance.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable, the insecure party may suspend any performance for which he has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)), the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Agreed". Section 1-201(3).
"Between merchants". Section 2104(3).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Writing". Section 1-201(46).

§ 25-2A-402. Anticipatory repudiation.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to G.S. 25-2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (G.S. 25-2A-524). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-403. Retraction of anticipatory repudiation.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under G.S. 25-2A-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) as unnecessary, implying no substantive change.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 25-2A-404. Substituted performance.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail, or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance shall be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-405. Excused performance.

Subject to G.S 25-2A-404 on substituted performance, the following rules apply:

(a) delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the lease contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) if the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he shall allocate production and deliveries among his customers but at his option may include regular customers not then under contract for sale or lease as well as his own requirements for further manufacture. He may so allocate in any manner that is fair and reasonable.

(c) the lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreed". Section 1-201(3).
"Contract". Section 1-201(11).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Sale". Section 2-106(1).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-406. Procedure on excused performance.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under G.S. 25-2A-405, the lessee may, by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract, the value of the whole lease contract is substantially impaired (G.S. 25-2A-510):

(a) terminate the lease contract (G.S. 25-2A-505(2)); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under G.S. 25-2A-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding 30 days, the lease contract lapses with respect to any deliveries affected. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2).

Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405). However, subsection 1(b), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407.

Definitional Cross References:
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Written". Section 1-201(46).

§ 25-2A-407. Irrevocable promises: finance leases.

(1) In the case of a finance lease that is not a consumer lease, the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1) of this section:

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties; and

(b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

(3) This section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes:

1. This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209. Thus, upon the lessee's acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203), and the lessee's revocation of acceptance (Section 2A-517).

2. The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 2A-211(1)). This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract and, in some cases, the warranty of a manufacturer who is not the supplier, is extended to the lessee under the finance lease. Section 2A-209. Despite this balance, this section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C. § 1666i (1982)).

3. The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contracted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)), this transaction should qualify as a finance lease. Section 2A-103(1)(g).

4. The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later the line of equipment malfunctions and B falls behind in its manufacturing schedule.

5. Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213. Absent an express provision in the lease agreement, application of Section 2A-210 or Section 2A-211(1), or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103), B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)). B has no right to set-off with respect to any part of the rent still due under the lease. Section 2A-508(6). However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1).

6. This section does not address whether a "hell or high water" clause, i.e., a clause that is to the effect of this section, is enforceable if

included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case and other law which this section does not affect. Sections 2A-104, 2A-103(4), 9-206 and 9-318. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

7. Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References:
Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318.

Definitional Cross References:
"Cancellation". Section 2A-103(1)(b).
"Consumer lease". Section 2A-103(1)(e).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).
"Termination". Section 2A-103(1)(z).

PART 5.

DEFAULT.

Subpart A. In General.

§ 25-2A-501. Default: procedure.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this Article and, except as limited by this Article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this Article.

(4) Except as otherwise provided in G.S. 25-1-305(a) or this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) of this section are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this Part does not apply. (1993, c. 463, s. 1; 2006-112, s. 7.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501.

Changes: Substantially revised.

Purposes:
1. Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A-508 and 2A-523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

2. Subsection (2) is a version of the first sentence of Section 9-501(1), revised to reflect leasing terminology.

3. Subsection (3), an expansive version of the second sentence of Section 9-501(1), lists the procedures that may be followed by the party

seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

4. Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S. F.L.Rev. 257, 276-80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section 1-106, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.

5. Section 9-501(3), which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References:

Sections 1-106, 2A-508, 2A-523, Article 9, especially Sections 9-501(1) and 9-501(3).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 7, effective October 1, 2006, substituted "G.S. 25-1-305(a)" for "G.S. 25-1-106(1)" in subsection (4).

§ 25-2A-502. Notice after default.

Except as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes:

This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a), the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2).

Cross References:

Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5.

Definitional Cross References:

"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).

§ 25-2A-503. Modification or impairment of rights and remedies.

(1) Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

(2) Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.

(3) Consequential damages may be liquidated under G.S. 25-2A-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation, alteration, or exclusion of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation, alteration, or exclusion of damages where the loss is commercial is not prima facie unconscionable.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this Article. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701.

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504.

Purposes:

1. A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3). Thus, subsection (1), a revised version of the provisions of Section 2-719(1), allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and (2)), this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

2. Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 official comment 1.

3. Subsection (3), a revision of Section 2-719(3), makes clear that consequential damages may also be liquidated. Section 2A-504(1).

4. Subsection (4) is a revision of the provisions of Section 2-701. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References:

Sections 1-102(3), 1-103, Article 2, especially Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), and 2A-504.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Consumer goods". Section 9-109(1).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 25-2A-504. Liquidation of damages.

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then-anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does not comply with subsection (1) of this section, or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (G.S. 25-2A-525 or G.S. 25-2A-526), the lessee is entitled to restitution of any amount by which the sum of his payments exceeds:

- (a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1) of this section; or
- (b) in the absence of those terms, twenty percent (20%) of the then-present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or five hundred dollars ($500.00).

(4) A lessee's right to restitution under subsection (3) of this section is subject to offset to the extent the lessor establishes:

- (a) a right to recover damages under the provisions of this Article other than subsection (1) of this section; and
- (b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2).

Changes: Substantially rewritten.

Purposes:

Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1), provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1), provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-201(37). E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D.Wis.1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, i.e., difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1), providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2), provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of $500 contained in Section 2-718 is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References:

Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2).

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Value". Section 1-201(44).

CASE NOTES

The parties to a lease transaction are free to negotiate the amount of liquidated damages, restrained only by the rule of reasonableness. Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

The basic test of the reasonableness of an agreement liquidating damages is whether the stipulated amount of or amount produced by the stipulated formula represents a reasonable forecast of the probable loss. Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

Illustrative Case. — Liquidated damages clause was a reasonable estimation of the then-anticipated damages in the event of default where it protected plaintiff's expectation interest and it placed plaintiff in the position it would have occupied had the lease been fully performed by allowing it to accelerate the balance of the lease payments and repossess equipment. Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

§ 25-2A-505. Cancellation and termination and effect of cancellation, termination, rescission, or fraud on rights and remedies.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation", "rescission", or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this Article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Cancellation". Section 2A-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).

§ 25-2A-506. Statute of limitations.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within four years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) of this section is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this Article becomes effective. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725.

Changes: Substantially rewritten.

Purposes:

Subsection (1) does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule of Section 2-725(2) is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References:
Sections 2-725(1) and 2-725(2).

Definitional Cross References:
"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Lease contract". Section 2A-103(1)(*l*).

"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Termination". Section 2A-103(1)(z).

CASE NOTES

Breach of Lease Suit Not Barred by Statute of Limitations. — Trial court erred in granting a lessee's summary judgment motion in a breach of a contract action filed by a lessor based on a three-year statute of limitations as the agreement was a lease under the North Carolina Uniform Commercial Code, specifically G.S. 25-2A-103(j), since it was originally structured with a four-year lease term; after the lease was modified by the bankruptcy court, the lessee was obligated to make 21 consecutive monthly payments beginning in August 1998 and the suit was not barred under the four-year statute of limitations for leases set forth in G.S. 25-2A-506(1). Finova Capital Corp. v. Beach Pharm. II, Ltd., 175 N.C. App. 184, 623 S.E.2d 289, 2005 N.C. App. LEXIS 2741 (2005).

§ 25-2A-507. Proof of market rent: time and place.

(1) Damages based on market rent (G.S. 25-2A-519 or G.S. 25-2A-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times specified in G.S. 25-2A-519 and G.S. 25-2A-528.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this Article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this Article offered by one party is not admissible unless and until he has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724.

Changes: Revised to reflect leasing practices and terminology. Sections 2A-519 and 2A-528 specify the times as of which market rent is to be determined.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A103(1)(k).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Usage of trade". Section 1-205.
"Value". Section 1-201(44).

Subpart B. Default by Lessor.

§ 25-2A-508. Lessee's remedies.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (G.S. 25-2A-509) or repudiates the lease contract (G.S. 25-2A-402), or a lessee rightfully rejects the goods (G.S. 25-2A-509) or justifiably revokes acceptance of the goods (G.S. 25-2A-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract, the value of the whole lease contract is substantially impaired (G.S. 25-2A-510), the lessor is in default under the lease contract, and the lessee may:

(a) cancel the lease contract (G.S. 25-2A-505(1));

(b) recover so much of the rent and security as has been paid and is just under the circumstances;

(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (G.S. 25-2A-518 and G.S. 25-2A-520), or recover damages for nondelivery (G.S. 25-2A-519 and G.S. 25-2A-520);

(d) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (G.S. 25-2A-522); or

(b) in a proper case, obtain specific performance or replevy the goods (G.S. 25-2A-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease, and in G.S. 25-2A-519(3).

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (G.S. 25-2A-519(4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to G.S. 25-2A-527(5). A lessee who has rightfully rejected the goods, or justifiably revoked acceptance of the goods, shall account to the lessor for any excess over the amount of the lessee's security interest.

(6) Subject to the provisions of G.S. 25-2A-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717.

Changes: Substantially rewritten.

Purposes:

1. This section is an index to Sections 2A-509 through 522 which set out the lessee's rights and remedies after the lessor's default. The lessor and the lessee can agree to modify the rights and remedies available under this Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessee can exercise the rights and remedies referred to in subsection (1); and they can create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

2. Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1), lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4). Subsection

(1) also allows the lessee to exercise any contractual remedy. This Article rejects any general doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Use of multiple remedies is barred only if the effect is to put the lessee in a better position than it would have been in had the lessor fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1). Subsection 1(b), in recognition that no bright line can be created that would operate fairly in all installment-lease cases and in recognition of the fact that a lessee may be able to cancel the lease (revoke acceptance of the goods) after the goods have been in use for some period of time, does not require that all lease payments made by the lessee under the lease be returned upon cancellation. Rather, only such portion as is just of the rent and security payments made may be recovered. If a defect in the goods is discovered immediately upon tender to the lessee and the goods are rejected immediately, then the lessee should recover all payments made. If, however, for example, a 36-month equipment lease is terminated in the 12th month because the lessor has materially breached the contract by failing to perform its maintenance obligations, it may be just to return only a small part or none of the rental payments already made.

3. Subsection (2), a version of the provisions of Section 2-711(2) revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

4. Subsection (3) is new. It covers defaults which do not deprive the lessee of the goods and which are not so serious as to justify rejection or revocation of acceptance under subsection (1). It also covers defaults for which the lessee could have rejected or revoked acceptance of the goods but elects not to do so and retains the goods. In either case, a lessee which retains the goods is entitled to recover damages as stated in Section 2A-519(3). That measure of damages is "the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's breach."

5. Subsection (1)(d) and subsection (3) recognize that the lease agreement may provide rights and remedies in addition to or different from those which Article 2A provides. In particular, subsection (3) provides that the lease agreement may give the remedy of cancellation of the lease for defaults by the lessor that would not otherwise be material defaults which would justify cancellation under subsection (1). If there is a right to cancel, there is, of course, a right to reject or revoke acceptance of the goods.

6. Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor justifying revocation of acceptance. If the lessee properly rejects or revokes acceptance of the goods because of a breach of warranty, the rights and remedies are those provided in subsection (1) rather than those in Section 2A-519(4).

7. Subsection (5), a revised version of the provisions of Section 2-711(3), recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113, which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4), a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor, or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512. However, Section 2A-517(5) provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) will apply to the lessee's disposition of such goods.

8. Pursuant to Section 2A-527(5), the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

9. Subsection (6), a slightly revised version of the provisions of Section 2-717, sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 with respect to irrevocable promises in a finance lease that is not a consumer lease, and further subject to an enforceable "hell or high water" clause in the lease agreement. Section 2A-407 official comment. No attempt is made to state how the set-off should occur; this is to be determined by the facts of each case.

10. There is no special treatment of the finance lease in this section. Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Sections 2A-210 and 2A-211(1). Since the lessee will look to the supplier for performance, this is appropriate. Section 2A-209.

Cross References:

Sections 1-102(3), 1-103, 1-106(1), Article 2, especially Sections 2-711, 2-717 and Sections 2A-103(4), 2A-209, 2A-210, 2A-211(1), 2A-407, 2A-501(2), 2A-501(4), 2A-509 through 2A-522, 2A-511(3), 2A-517(5), 2A-527(5) and Section 9-113.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

§ 25-2A-509. Lessee's rights on improper delivery; rightful rejection.

(1) Subject to the provisions of G.S. 25-2A-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-601 and 2-602(1).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Commercial unit". Section 2A103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).

§ 25-2A-510. Installment lease contracts; rejection and default.

(1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (2) of this section and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole, there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-612.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Installment lease contract". Section 2A-103(1)(i).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-511. Merchant lessee's duties as to rightfully rejected goods.

(1) Subject to any security interest of a lessee (G.S. 25-2A-508(5)), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions, a merchant lessee shall make reasonable efforts to sell, lease, or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if, on demand, indemnity for expenses is not forthcoming.

(2) If a merchant lessee (subsection (1) of this section) or any other lessee (G.S. 25-2A-512) disposes of goods, he is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding ten percent (10%) of the gross proceeds.

(3) In complying with this section or G.S. 25-2A-512, the lessee is held only to good faith. Good faith conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or G.S. 25-2A-512 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this Article. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-603 and 2-706(5).

Changes: Revised to reflect leasing practices and terminology. This section, by its terms, applies to merchants as well as others. Thus, in construing the section it is important to note that under this Act the term good faith is defined differently for merchants (Section 2-103(1)(b)) than for others (Section 1-201(19)). Section 2A-103(3) and (4).

Definitional Cross References:
"Action". Sections 1-201(1).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant lessee". Section 2A-103(1)(t).
"Purchaser". Section 1-201(33).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-512. Lessee's duties as to rightfully rejected goods.

(1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (G.S. 25-2A-511) and subject to any security interest of a lessee (G.S. 25-2A-508(5)):

(a) the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) if the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the lessor's or the supplier's account with reimbursement in the manner provided in G.S. 25-2A-511; but

(c) the lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to subsection (1) of this section is not acceptance or conversion. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-602(2)(b) and (c) and 2-604.

Changes: Substantially rewritten.

Purposes:

The introduction to subsection (1) references goods that threaten to decline in value speedily and not perishables, the reference in Section 2-604, the statutory analogue. This is a change in style, not substance, as the first phrase includes the second. Subparagraphs (a) and (c) are revised versions of the provisions of Section 2-602(2)(b) and (c). Subparagraph (a) states the rule with respect to the lessee's treatment of goods in its possession following rejection; subparagraph (b) states the rule regarding such goods if the lessor or supplier then fails to give instructions to the lessee. If the lessee performs in a fashion consistent with subparagraphs (a) and (b), subparagraph (c) exonerates the lessee.

Cross References:

Sections 2-602(2)(b), 2-602(2)(c) and 2-604.

Definitional Cross References:

"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-513. Cure by lessor of improper tender or delivery; replacement.

(1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he seasonably notifies the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-508.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Notifies". Section 1-201(26).

"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-514. Waiver of lessee's objections.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (G.S. 25-2A-513); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent in the documents. (1993, c. 463, s. 1; 2006-112, s. 39.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-605.

Changes: Revised to reflect leasing practices and terminology.

Purposes:

The principles applicable to the commercial practice of payment against documents (subsection 2) are explained in official comment 4 to Section 2-605, the statutory analogue to this section.

Cross Reference:

Section 2-605 official comment 4.

Definitional Cross References:

"Between merchants". Section 2-104(3).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Writing". Section 1-201(46).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 39, effective October 1, 2006, substituted "in" for "on the face of" in subsection (2).

§ 25-2A-515. Acceptance of goods.

(1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and:

(a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) the lessee fails to make an effective rejection of the goods (G.S. 25-2A-509(2)).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-606.

Changes: The provisions of Section 2-606(1)(a) were substantially rewritten to provide that the lessee's conduct may signify acceptance. Further, the provisions of Section 2-606(1)(c) were not incorporated as irrelevant given the lessee's possession and use of the leased goods.

Cross References:
Sections 2-606(1)(a) and 2-606(1)(c).

Definitional Cross References:
"Commercial unit". Section 2A103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-516. Effect of acceptance of goods; notice of default; burden of establishing default after acceptance; notice of claim or litigation to person answerable over.

(1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this Article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any remedy against the party not notified;

(b) except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (G.S. 25-2A-211) the lessee shall notify the lessor or be barred from any remedy over for liability established by the litigation; and

(c) the burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over the following apply:

(a) the lessee may give the lessor or the supplier, or both, written notice of the litigation. If the notice states that the person notified may come in and defend and that if the person notified does not do so, that person will be bound in any action against that person by the lessee by any determination of fact common to the two litigations, then, unless the person notified after seasonable receipt of the notice does come in and defend, that person is so bound.

(b) the lessor or the supplier may demand in writing that the lessee turn over control of the litigation, including settlement, if the claim is one for infringement or the like (G.S. 25-2A-211) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then, unless the lessee after seasonable receipt of the demand does turn over control, the lessee is so barred.

(5) Subsections (3) and (4) of this section apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (G.S. 25-2A-211). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-607.

Changes: Substantially revised.

Purposes:

1. Subsection (2) creates a special rule for finance leases, precluding revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement; this is not inequitable as the lessee has a direct claim against the supplier. Section 2A-209(1). Revocation of acceptance of a finance lease is permitted if the lessee's acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. Section 2A-517(1)(b). Absent exclusion or modification, the lessor under a finance lease makes certain warranties to the lessee. Sections 2A-210 and 2A-211(1). Revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-407 official comment. Where the finance lease creates a security interest, the rule may be to the contrary. General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co., 806 F.2d 1207 (3rd Cir. 1986).

2. Subsection (3)(a) requires the lessee to give notice of default, within a reasonable time after the lessee discovered or should have discovered the default. In a finance lease, notice may be given either to the supplier, the lessor, or both, but remedy is barred against the party not notified. In a finance lease, the lessor is usually not liable for defects in the goods and the essential notice is to the supplier. While notice to the finance lessor will often not give any additional rights to the lessee, it would be good practice to give the notice since the finance lessor has an interest in the goods. Subsection (3)(a) does not use the term finance lease, but the definition of supplier is a person from whom a lessor buys or leases goods to be leased under a finance lease. Section 2A-103(1)(x). Therefore, there can be a "supplier" only in a finance lease. Subsection (4) applies similar notice rules as to lessors and suppliers if a lessee is sued for a breach of warranty or other obligation for which a lessor or supplier is answerable over.

3. Subsection (3)(b) requires the lessee to give the lessor notice of litigation for infringement or the like. There is an exception created in the case of a consumer lease. While such an exception was considered for a finance lease, it was not created because it was not necessary — the lessor in a finance lease does not give a warranty against infringement. Section 2A-211(2). Even though not required under subsection (3)(b), the lessee who takes under a finance lease should consider giving notice of litigation for infringement or the like to the supplier, because the lessee obtains the benefit of the suppliers' promises subject to the suppliers' defenses or claims. Sections 2A-209(1) and 2-607(3)(b).

Cross References:

Sections 2-607(3)(b), 2A-103(1)(x), 2A-209(1), 2A-210, 2A-211(1), 2A-211(2), 2A-407 official comment and 2A-517(1)(b).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreement". Section 1-201(3).
"Burden of establishing". Section 1-201(8).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A103(1)(e).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Notifies". Section 1-201(26).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Written". Section 1-201(46).

§ 25-2A-517. Revocation of acceptance of goods.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if the lessee has accepted it:

(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.

(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.

(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.

(5) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-608.

Changes: Revised to reflect leasing practices and terminology. Note that in the case of a finance lease the lessee retains a limited right to revoke acceptance. Sections 2A-517(1)(b) and 2A-516 official comment. New subsections (2) and (3) added.

Purposes:

1. The section states the situations under which the lessee may return the goods to the lessor and cancel the lease. Subsection (2) recognizes that the lessor may have continuing obligations under the lease and that a default as to those obligations may be sufficiently material to justify revocation of acceptance of the leased items and cancellation of the lease by the lessee. For example, a failure by the lessor to fulfill its obligation to maintain leased equipment or to supply other goods which are necessary for the operation of the leased equipment may justify revocation of acceptance and cancellation of the lease.

2. Subsection (3) specifically provides that the lease agreement may provide that the lessee can revoke acceptance for defaults by the lessor which in the absence of such an agreement might not be considered sufficiently serious to justify revocation. That is, the parties are free to contract on the question of what defaults are so material that the lessee can cancel the lease.

Cross References:

Section 2A-516 official comment.

Definitional Cross References:

"Commercial unit". Section 2A103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lot". Section 2A-103(1)(s).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Value". Section 1-201(44).

§ 25-2A-518. Cover; substitute goods.

(1) After a default by a lessor under the lease contract of the type described in G.S. 25-2A-508(1), or, if agreed, after other default by the lessor, the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-302 and G.S. 25-2A-503), if a lessee's cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and G.S. 25-2A-519 governs. (1993, c. 463, s. 1; 2006-112, s. 8.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-712.

Changes: Substantially revised.

Purposes:

1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507.

2. Subsection (2) states a rule for determining the amount of lessee's damages provided that there is no agreement to the contrary. The lessee's damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period which is comparable to the then remaining term of the original lease agreement less the present value of the rent reserved for the remaining term under the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor's default. Consequential damages may include loss suffered by the lessee because of deprivation of the use of the goods during the period between the default and the acquisition of the goods under the new lease agreement. If the lessee's cover does not satisfy the criteria of subsection (2), Section 2A-519 governs.

3. Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus, the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

4. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor's breach it was not possible to obtain the same type of goods in the market place. Because the lessee's remedy under Section 2A-519 is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2-712(1).

5. Second, the various elements of the new lease agreement should also be examined. Those elements include the presence or absence of options to purchase or release; the lessor's representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the

amount of rent to be paid. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to adjust the difference in rental to take account of the difference between the two leases, find that the new lease is substantially similar to the old lease, and award cover damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from the rent due under the new lease before determining the difference in rental between the two leases.

6. Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar commercial realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

Cross References:
Sections 2-712(1), 2A-519 and 9-507.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Contract". Section 1-201(11).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Purchase". Section 2A-103(1)(v).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 8, effective October 1, 2006, substituted "G.S. 25-1-302" for "G.S. 25-1-102(3)" in subsection (2).

§ 25-2A-519. Lessee's damages for nondelivery, repudiation, default, and breach of warranty in regard to accepted goods.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-302 and G.S. 25-2A-503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under G.S. 25-2A 518(2), or is by purchase or otherwise, the measure of damages for nondelivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the

present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) Except as otherwise agreed, if the lessee has accepted goods and given notification (G.S. 25-2A-516(3)), the measure of damages for nonconforming tender or delivery or other default by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) Except as otherwise agreed, the measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty. (1993, c. 463, s. 1; 2006-112, s. 9.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-713 and 2-714.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-713(1), states the basic rule governing the measure of lessee's damages for non-delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-518. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference in Section 2A-519(1) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, G.S. 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103.

3. Subsection (2), a revised version of the provisions of Section 2-713(2), states the rule with respect to determining market rent.

4. Subsection (3), a revised version of the provisions of Section 2-714(1) and (3), states the measure of damages where goods have been accepted and acceptance is not revoked. The subsection applies both to defaults which occur at the inception of the lease and to defaults which occur subsequently, such as failure to comply with an obligation to maintain the leased goods. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

5. Subsection (4), a revised version of the provisions of Section 2-714(2), states the measure of damages for breach of warranty. The measure in essence is the present value of the difference between the value of the goods accepted and of the goods if they had been as warranted.

6. Subsections (1), (3) and (4) specifically state that the parties may by contract vary the damages rules stated in those subsections.

Cross References:

Sections 2-713(1), 2-713(2), 2-714 and Section 2A-518.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Present value". Section 2A-103(1)(u).
"Value". Section 1-201(44).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 9, effective October 1, 2006, substituted "G.S. 25-1-302" for "G.S. 25-1-102(3)" in subsection (1).

§ 25-2A-520. Lessee's incidental and consequential damages.

(1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) any loss resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-715.

Changes: Revised to reflect leasing terminology and practices.

Purposes:

Subsection (1), a revised version of the provisions of Section 2-715(1), lists some examples of incidental damages resulting from a lessor's default; the list is not exhaustive. Subsection (1) makes clear that it applies not only to rightful rejection, but also to justifiable revocation.

Subsection (2), a revised version of the provisions of Section 2-715(2), lists some examples of consequential damages resulting from a lessor's default; the list is not exhaustive.

Cross References:

Section 2-715.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).

§ 25-2A-521. Lessee's right to specific performance or replevin.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances.

(2) A decree for specific performance may include any terms and conditions as to payment of the rent, damages, or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect recovery for those goods or the circumstances reasonably indicate that the effort will be unavailing. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-716.

Changes: Revised to reflect leasing practices and terminology, and to expand the reference to the right of replevin in subsection (3) to include other similar rights of the lessee.

Definitional Cross References:
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).

§ 25-2A-522. Lessee's right to goods on lessor's insolvency.

(1) Subject to subsection (2) of this section and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (G.S. 25-2A-217) on making and keeping good a tender of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within 10 days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-502.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).

Subpart C. Default by Lessee.

§ 25-2A-523. Lessor's remedies.

(1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (G.S. 25-2A-510), the lessee is in default under the lease contract and the lessor may:
(a) cancel the lease contract (G.S. 25-2A-505(1));
(b) proceed respecting goods not identified to the lease contract (G.S. 25-2A-524);
(c) withhold delivery of the goods and take possession of goods previously delivered (G.S. 25-2A-525);
(d) stop delivery of the goods by any bailee (G.S. 25-2A-526);
(e) dispose of the goods and recover damages (G.S. 25-2A-527), or retain the goods and recover damages (G.S. 25-2A-528), or in a proper case recover rent (G.S. 25-2A-529);
(f) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1) of this section, the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.

(3) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) if the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in subsections (1) or (2) of this section; or

(b) if the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in subsection (2) of this section. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-703.

Changes: Substantially revised.

Purposes:

1. Subsection (1) is an index to Sections 2A-524 through 2A-531 and states that the remedies provided in those sections are available for the defaults referred to in subsection (1): wrongful rejection or revocation of acceptance, failure to make a payment when due, or repudiation. In addition, remedies provided in the lease contract are available. Subsection (2) sets out a remedy if the lessor does not pursue to completion a right or actually obtain a remedy available under subsection (1), and subsection (3) sets out statutory remedies for defaults not specifically referred to in subsection (1). Subsection (3) provides that, if any default by the lessee other than those specifically referred to in subsection (1) is material, the lessor can exercise the remedies provided in subsection (1) or (2); otherwise the available remedy is as provided in subsection (3). A lessor who has brought an action seeking or has nonjudicially pursued one or more of the remedies available under subsection (1) may amend so as to claim or may nonjudicially pursue a remedy under subsection (2) unless the right or remedy first chosen has been pursued to an extent actually inconsistent with the new course of action. The intent of the provision is to reject the doctrine of election of remedies and to permit an alteration of course by the lessor unless such alteration would actually have an effect on the lessee that would be unreasonable under the circumstances. Further, the lessor may pursue remedies under both subsections (1) and (2) unless doing so would put the lessor in a better position than it would have been in had the lessee fully performed.

2. The lessor and the lessee can agree to modify the rights and remedies available under the Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessor can exercise the rights and remedies referred to in subsection (1), whether or not the default would otherwise be held to substantially impair the value of the lease contract to the lessor; they can also create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

3. Subsection (1), a substantially rewritten version of Section 2-703, lists various cumulative remedies of the lessor where the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates. Section 2A-501(2) and (4). The subsection also allows the lessor to exercise any contractual remedy.

4. This Article rejects any general doctrine of election of remedy. Whether, in a particular case, one remedy bars another, is a function of whether lessor has been put in as good a position as if the lessee had fully performed the lease contract. Multiple remedies are barred only if the effect is to put the lessor in a better position than it would have been in had the lessee fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1).

5. Hypothetical: To better understand the application of subparagraphs (a) through (e), it is useful to review a hypothetical. Assume that A is a merchant in the business of selling and leasing new bicycles of various types. B is about to engage in the business of subleasing bicycles to summer residents of and visitors to an island resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's island location on June 1; the term of the lease of these bicycles is four months. 20 bicycles are to be delivered by A to B's island location on July 1; the term of the lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A to B's island location on August 1; the term of the lease of these bicycles is two months. B is obligated to pay rent to A on the 15th day of each month during the term for the lease. Rent is $50 per month, per bicycle. B has no option to purchase or release and must return the bicycles to A at the end of the term, in good condition, reasonable wear and tear excepted. Since the retail price of each bicycle is $400 and bicycles used in the retail rental business have a useful economic life of 36 months, this transaction creates a lease. Sections 2A-103(1)(j) and 1-201(37).

6. A's current inventory of bicycles is not large. Thus, upon signing the lease with B in February, A agreed to purchase 60 new bicycles from A's principal manufacturer, with special instructions to drop ship the bicycles to B's

island location in accordance with the delivery schedule set forth in the lease.

7. The first shipment of 20 bicycles was received by B on May 21. B inspected the bicycles, accepted the same as conforming to the lease and signed a receipt of delivery and acceptance. However, due to poor weather that summer, business was terrible and B was unable to pay the rent due on June 15. Pursuant to the lease A sent B notice of default and proceeded to enforce his rights and remedies against B.

8. A's counsel first advised A that under Section 2A-510(2) and the terms of the lease B's failure to pay was a default with respect to the whole. Thus, to minimize A's continued exposure, A was advised to take possession of the bicycles. If A had possession of the goods A could refuse to deliver. Section 2A-525(1). However, the facts here are different. With respect to the bicycles in B's possession, A has the right to take possession of the bicycles, without breach of the peace. Section 2A-525(2). If B refuses to allow A access to the bicycles, A can proceed by action, including replevin or injunctive relief.

9. With respect to the 40 bicycles that have not been delivered, this Article provides various alternatives. First, assume that 20 of the remaining 40 bicycles have been manufactured and delivered by the manufacturer to a carrier for shipment to B. Given the size of the shipment, the carrier was using a small truck for the delivery and the truck had not yet reached the island ferry when the manufacturer (at the request of A) instructed the carrier to divert the shipment to A's place of business. A's right to stop delivery is recognized under these circumstances. Section 2A-526(1). Second, assume that the 20 remaining bicycles were in the process of manufacture when B defaulted. A retains the right (as between A as lessor and B as lessee) to exercise reasonable commercial judgment whether to complete manufacture or to dispose of the unfinished goods for scrap. Since A is not the manufacturer and A has a binding contract to buy the bicycles, A elected to allow the manufacturer to complete the manufacture of the bicycles, but instructed the manufacturer to deliver the completed bicycles to A's place of business. Section 2A-524(2).

10. Thus, so far A has elected to exercise the remedies referred to in subparagraphs (b) through (d) in subsection (1). None of these remedies bars any of the others because A's election and enforcement merely resulted in A's possession of the bicycles. Had B performed A would have recovered possession of the bicycles. Thus A is in the process of obtaining the benefit of his bargain. Note that A could exercise any other rights or pursue any other remedies provided in the lease contract (Section 2A-523(1)(f)), or elect to recover his loss due to the lessee's default under Section 2A-523(2).

11. A's counsel next would determine what action, if any, should be taken with respect to the goods. As stated in subparagraph (e) and as discussed fully in Section 2A-527(1) the lessor may, but has no obligation to, dispose of the goods by a substantially similar lease (indeed, the lessor has no obligation whatsoever to dispose of the goods at all) and recover damages based on that action, but lessor will not be able to recover damages which put it in a better position than performance would have done, nor will it be able to recover damages for losses which it could have reasonably avoided. In this case, since A is in the business of leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail trade.

12. A's counsel then will determine which of the various means of ascertaining A's damages against B are available. Subparagraph (e) catalogues each relevant section. First, under Section 2A-527(2) the amount of A's claim is computed by comparing the original lease between A and B with any subsequent lease of the bicycles but only if the subsequent lease is substantially similar to the original lease contract. While the section does not define this term, the official comment does establish some parameters. If, however, A elects to lease the bicycles to his retail trade, it is unlikely that the resulting lease will be substantially similar to the original, as leases to retail customers are considerably different from leases to wholesale customers like B. If, however, the leases were substantially similar, the damage claim is for accrued and unpaid rent to the beginning of the new lease, plus the present value as of the same date, of the rent reserved under the original lease for the balance of its term less the present value as of the same date of the rent reserved under the replacement lease for a term comparable to the balance of the term of the original lease, together with incidental damages less expenses saved in consequence of the lessee's default.

13. If the new lease is not substantially similar or if A elects to sell the bicycles or to hold the bicycles, damages are computed under Section 2A-528 or 2A-529.

14. If A elects to pursue his claim under Section 2A-528(1) the damage rule is the same as that stated in Section 2A-527(2) except that damages are measured from default if the lessee never took possession of the goods or from the time when the lessor did or could have regained possession and that the standard of comparison is not the rent reserved under a substantially similar lease entered into by the lessor but a market rent, as defined in Section 2A-507. Further, if the facts of this hypothetical were more elaborate A may be able to establish that the measure of damage under subsection (1) is inadequate to put him in the same position that B's performance would have, in which

case A can claim the present value of his lost profits.

15. Yet another alternative for computing A's damage claim against B which will be available in some situations is recovery of the present value, as of entry of judgment, of the rent for the then remaining lease term under Section 2A-529. However, this formulation is not available if the goods have been repossessed or tendered back to A. For the 20 bicycles repossessed and the remaining 40 bicycles, A will be able to recover the present value of the rent only if A is unable to dispose of them, or circumstances indicate the effort will be unavailing. If A has prevailed in an action for the rent, at any time up to collection of a judgment by A against B, A might dispose of the bicycles. In such case A's claim for damages against B is governed by Section 2A-527 or 2A-528. Section 2A-529(3). The resulting recalculation of claim should reduce the amount recoverable by A against B and the lessor is required to cause an appropriate credit to be entered against the earlier judgment. However, the nature of the post-judgment proceedings to resolve the issue, and the sanctions for a failure to comply, if any, will be determined by other law.

16. Finally, if the lease agreement had so provided pursuant to subparagraph (f), A's claim against B would not be determined under any of these statutory formulae, but pursuant to a liquidated damages clause. Section 2A-504(1).

17. These various methods of computing A's damage claim against B are alternatives subject to Section 2A-501(4). However, the pursuit of any one of these alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain possession of the 60 bicycles. These formulae, which vary as a function of an overt or implied mitigation of damage theory, focus on allowing A a recovery of the benefit of his bargain with B. Had B performed, A would have received the rent as well as the return of the 60 bicycles at the end of the term.

18. Finally, A's counsel should also advise A of his right to cancel the lease contract under subparagraph (a). Section 2A-505(1). Cancellation will discharge all existing obligations but preserve A's rights and remedies.

19. Subsection (2) recognizes that a lessor who is entitled to exercise the rights or to obtain a remedy granted by subsection (1) may choose not to do so. In such cases, the lessor can recover damages as provided in subsection (2). For example, for non-payment of rent, the lessor may decide not to take possession of the goods and cancel the lease, but rather to merely sue for the unpaid rent as it comes due plus lost interest or other damages "determined in any reasonable manner." Subsection (2) also negates any loss of alternative rights and remedies by reason of having invoked or commenced the exercise or pursuit of any one or more rights or remedies.

20. Subsection (3) allows the lessor access to a remedy scheme provided in this Article as well as that contained in the lease contract if the lessee is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplementary principles of law and equity, e.g., fraud, misrepresentation and duress. Sections 2A-103(4) and 1-103.

21. There is no special treatment of the finance lease in this section. Absent supplementary principles of law to the contrary, in most cases the supplier will have no rights or remedies against the defaulting lessee. Section 2A-209(2)(ii). Given that the supplier will look to the lessor for payment, this is appropriate. However, there is a specific exception to this rule with respect to the right to identify goods to the lease contract. Section 2A-524(2). The parties are free to create a different result in a particular case. Sections 2A-103(4) and 1-102(3).

Cross References:

Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2-703, 2A-103(1)(j), 2A-103(4), 2A-209(2)(ii), 2A-501(4), 2A-504(1), 2A-505(1), 2A-507, 2A-510(2), 2A-524 through 2A-531, 2A-524(2), 2A-525(1), 2A-525(2), 2A-526(1), 2A-527(1), 2A-527(2), 2A-528(1) and 2A-529(3).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-524. Lessor's right to identify goods to lease contract.

(1) After default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor may:

(a) identify to the lease contract conforming goods not already identified if at the time the lessor learned of the default they were in the lessor's or the supplier's possession or control; and
(b) dispose of goods (G.S. 25-2A-527(1)) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-704.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Learn". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-525. Lessor's right to possession of goods.

(1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) After a default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor has the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (G.S. 25-2A-527).

(3) The lessor may proceed under subsection (2) of this section without judicial process if it can be done without breach of the peace or the lessor may proceed by action. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-702(1) and 9-503.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-702(1), allows the lessor to refuse to deliver goods if the lessee is insolvent. Note that the provisions of Section 2-702(2), granting the unpaid seller certain rights of reclamation, were not incorporated in this section. Subsection (2) made this unnecessary.

2. Subsection (2), a revised version of the provisions of Section 9-503, allows the lessor, on a Section 2A-523(1) or 2A-523(3)(a) default by the lessee, the right to take possession of or reclaim the goods. Also, the lessor can contract for the right to take possession of the goods for other defaults by the lessee. Therefore, since the lessee's insolvency is an event of default in a standard lease agreement, subsection (2) is the functional equivalent of Section 2-702(2). Further, subsection (2) sanctions the classic crate and delivery clause obligating the lessee to assemble the goods and to make them available to the lessor. Finally, the lessor may leave the goods in place, render them unusable (if they are goods employed in trade or business), and dispose of them on the lessee's premises.

3. Subsection (3), a revised version of the provisions of Section 9-503, allows the lessor to proceed under subsection (2) without judicial

process, absent breach of the peace, or by action. Sections 2A-501(3), 2A-103(4) and 1-201(1). In the appropriate case action includes injunctive relief. Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. denied, 402 U.S. 909 (1971). This Section, as well as a number of other Sections in this Part, are included in the Article to codify the lessor's common law right to protect the lessor's reversionary interest in the goods. Section 2A-103(1)(q). These Sections are intended to supplement and not displace principles of law and equity with respect to the protection of such interest. Sections 2A-103(4) and 1-103. Such principles apply in many instances, e.g., loss or damage to goods if risk of loss passes to the lessee, failure of the lessee to return goods to the lessor in the condition stipulated in the lease, and refusal of the lessee to return goods to the lessor after termination or cancellation of the lease. See also Section 2A-532.

Cross References:
Sections 1-106(2), 2-702(1), 2-702(2), 2A-103(4), 2A-501(3), 2A-532 and 9-503.

Definitional Cross References:
"Action". Section 1-201(1).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 25-2A-526. Lessor's stoppage of delivery in transit or otherwise.

(1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security, or otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under subsection (1) of this section, the lessor may stop delivery until

(a) receipt of the goods by the lessee;

(b) acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) such an acknowledgment to the lessee by a carrier via reshipment or as a warehouse.

(3)(a) To stop delivery, a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(c) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor. (1993, c. 463, s. 1; 1995, c. 509, s. 23; 2006-112, s. 40.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-705.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Bill of lading". Section 1-201(6).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies" and "Notification". Section 1-201(26).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 40, effective October 1, 2006, substituted "a warehouse" for "warehouseman" in subdivision (2)(c).

§ 25-2A-527. Lessor's rights to dispose of goods.

(1) After a default by a lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or after the lessor refuses to deliver or takes possession of goods (G.S. 25-2A-525 or G.S. 25-2A-526), or, if agreed, after other default by a lessee, the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale, or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-302 and G.S. 25-2A-503), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods and G.S. 25-2A-528 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this Article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (G.S. 25-2A-508(5)). (1993, c. 463, s. 1; 2006-112, s. 10.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-706(1), (5) and (6).

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the first sentence of subsection 2-706(1), allows the lessor the right to dispose of goods after a statu-

tory or other material default by the lessee (even if the goods remain in the lessee's possession — Section 2A-525(2)), after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A-527(5).

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

3. The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date of the rent under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A-528. Section 2A-523(1)(e).

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

5. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the options to purchase or release; the lessor's representations, warranties and covenants to the lessee as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commercial judgment pervade the finding. See Section 2A-507(2). To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to find that the new lease is substantially similar to the old lease, adjust the difference in the rent between the two leases to take account of the differences, and award damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from rent due under the new lease before the difference in rental between the two leases is determined.

6. The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. It is a question of fact whether it is so difficult to adjust the recovery to take account of the difference between the two leases as to insurance that the second lease is not substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly un-

likely that a one-month rental and a five-year lease would reflect similar realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the remaining term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2nd. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

8. Subsection (3), which is new, provides that if the lessor's disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A-528 governs.

9. Subsection (4), a revised version of subsection 2-706(5), applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to disposition under this section. Note that by its terms, the rule in subsection 2A-304(1), which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

10. Subsection (5), a revised version of subsection 2-706(6), provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of good has no equity of redemption to protect.

Cross References:

Sections 1-102(3), 2-706(1), 2-706(5), 2-706(6), 2A-103(4), 2A-304(1), 2A-504, 2A-507(2), 2A-523(1)(e), 2A-525(2), 2A-517(5), 2A-528 and 9-507.

Definitional Cross References:

"Buyer" and "Buying". Section 2-103(1)(a).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 10, effective October 1, 2006, substituted "G.S. 25-1-302" for "G.S. 25-1-102(3)" in subsection (2).

CASE NOTES

Cited in Coastal Leasing Corp. v. T-Bar S Corp., 128 N.C. App. 379, 496 S.E.2d 795 (1998).

§ 25-2A-528. Lessor's damages for nonacceptance, failure to pay, repudiation, or other default.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-302 and G.S. 25-2A-503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under G.S. 25-2A-527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in G.S. 25-2A-523(1) or

G.S. 25-2A-523(3)(a), or if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(2) If the measure of damages provided in subsection (1) of this section, is inadequate to put a lessor in as good a position as performance would have, the measure of damages is the present value of the profit, including reasonable overhead, the lessor would have made from full performance by the lessee, together with any incidental damages allowed under G.S. 25-2A-530, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition. (1993, c. 463, s. 1; 2006-112, s. 11.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-708.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a substantially revised version of Section 2-708(1), states the basic rule governing the measure of lessor's damages for a default described in Section 2A-523(1) or (3)(a), and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A-527(2). Section 2A-527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-529. There is no sanction for disposition that does not qualify under subsection 2A-527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A-528(1)(i) and (ii) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103. If the lessee has taken possession of the goods, the measure of damages is the accrued and unpaid rent as of the earlier of the time the lessor repossesses the goods or the time the lessee tenders the goods to the lessor plus the difference between the present value, as of the same time, of the rent under the lease for the remaining lease term and the present value, as of the same time, of the market rent.

3. Market rent will be computed pursuant to Section 2A-507.

4. Subsection (2), a somewhat revised version of the provisions of subsection 2-708(2), states a measure of damages which applies if the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor's profit, including overhead, together with incidental damages, with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition a proper value should be attributed to the lessor's residual interest in the goods. Sections 2A-103(1)(q) and 2A-507(4).

5. In calculating profit, a court should include any expected appreciation of the goods, e.g. the foal of a leased brood mare. Because this subsection is intended to give the lessor the benefit of the bargain, a court should consider any reasonable benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. Lithonia Lighting, Inc., 317 F.Supp. 406, 413 (N.D.Ga. 1970);

Locks v. Wade, 36 N.J.Super. 128, 131, 114 A.2d 875, 877 (Super.Ct.App.Div. 1955). Further, in calculating profit the concept of present value must be given effect. Taylor v. Commercial credit Equip. Corp., 170 Ga.App. 322, 316 S.E.2d 788 (Ct.App. 1984). See generally Section 2A-103(1)(u).

Cross References:

Sections 1-102(3), 2-708, 2A-103(1)(u), 2A-402, 2A-504, 2A-507, 2A-527(2) and 2A-529.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Sale". Section 2-106(1).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 11, effective October 1, 2006, in subsection (1), substituted "G.S. 25-1-302" for "G.S. 25-1-102(3)" and "G.S. 25-2A-530" for "2A-530."

§ 25-2A-529. Lessor's action for the rent.

(1) After default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, if the lessor complies with subsection (2) of this section, the lessor may recover from the lessee as damages:

(a) for goods accepted by the lessee and not repossessed by or tendered to the lessor, and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (G.S. 25-2A-219), (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default; and

(b) for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(2) Except as provided in subsection (3) of this section, the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (1) of this section. If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages is governed by G.S. 25-2A-527 or G.S. 25-2A-528, and the lessor will cause an appropriate credit to be provided against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to G.S. 25-2A-527 or G.S. 25-2A-528.

(4) Payment of the judgment for damages obtained pursuant to subsection (1) of this section, entitles the lessee to the use and possession of the goods not

then disposed of for the remaining lease term of and in accordance with the lease agreement.

(5) After a default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, a lessor who is held not entitled to rent under this section must nevertheless be awarded damages for nonacceptance under G.S. 25-2A-527 or G.S. 25-2A-528. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-709.

Changes: Substantially revised.

Purposes:

1. Absent a lease contract provision to the contrary, an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose of them at a reasonable price after reasonable effort. There is no general right in a lessor to recover the full rent from the lessee upon holding the goods for the lessee. If the lessee tenders goods back to the lessor, and the lessor refuses to accept the tender, the lessor will be limited to the damages it would have suffered had it taken back the goods. The rule in Article 2 that the seller can recover the price of accepted goods is rejected here. In a lease, the lessor always has a residual interest in the goods which the lessor usually realizes upon at the end of a lease term by either sale or a new lease. Therefore, it is not a substantial imposition on the lessor to require it to take back and dispose of the goods if the lessee chooses to tender them back before the end of the lease term: the lessor will merely do earlier what it would have done any way, sell or relet the goods. Further, the lessee will frequently encounter substantial difficulties if the lessee attempts to sublet the goods for the remainder of the lease term. In contrast to the buyer who owns the entire interest in goods and can easily dispose of them, the lessee is selling only the right to use the goods under the terms of the lease and the sublessee must assume a relationship with the lessor. In that situation, it is usually more efficient to eliminate the original lessee as a middleman by allowing the lessee to return the goods to the lessor who can then redispose of them.

2. In some situations even where possession of the goods is reacquired, a lessor will be able to recover as damages the present value of the full rent due, not under this section, but under 2A-528(2) which allows a lost profit recovery if necessary to put the lessor in the position it would have been in had the lessee performed. Following is an example of such a case. A is a lessor of construction equipment and maintains a substantial inventory. B leases from A a backhoe for a period of two weeks at a rental of $1,000. After three days, B returns the backhoe and refuses to pay the rent. A has five backhoes in inventory, including the one returned by B. During the next 11 days after the return by B of the backhoe, A rents no more than three backhoes at any one time and, therefore, always has two on hand. If B had kept the backhoe for the full rental period. A would have earned the full rental on that backhoe, plus the rental on the other backhoes it actually did rent during that period. Getting this backhoe back before the end of the lease term did not enable A to make any leases it would not otherwise have made. The only way to put A in the position it would have been in had the lessee fully performed is to give the lessor the full rentals. A realized no savings at all because the backhoe was returned early and might even have incurred additional expense if it was paying for parking space for equipment in inventory. A has no obligation to relet the backhoe for the benefit of B rather than leasing the backhoe or any other in inventory for its own benefit. Further, it is probably not reasonable to expect A to dispose of the backhoe by sale when it is returned in an effort to reduce damages suffered by B. Ordinarily, the loss of a two-week rental would not require A to reduce the size of its backhoe inventory. Whether A would similarly be entitled to full rentals as lost profit in a one-year lease of a backhoe is a question of fact: in any event the lessor, subject to mitigation of damages rules, is entitled to be put in as good a position as it would have been had the lessee fully performed the lease contract.

3. Under subsection (2) a lessor who is able and elects to sue for the rent due under a lease must hold goods not lost or damaged for the lessee. Subsection (3) creates an exception to the subsection (2) requirement. If the lessor disposes of those goods prior to collection of the judgment (whether as a matter of law or agreement), the lessor's recovery is governed by the measure of damages in Section 2A-527 if the disposition is by lease that is substantially similar to the original lease, or otherwise by the measure of damages in Section 2A-528. Section 2A-523 official comment.

4. Subsection (4), which is new, further reinforces the requisites of Subsection (2). In the event the judgment for damages obtained by the lessor against the lessee pursuant to subsection (1) is satisfied, the lessee regains the right to use and possession of the remaining goods for the balance of the original lease term; a partial satisfaction of the judgment creates no right in the lessee to use and possession of the goods.

5. The relationship between subsections (2) and (4) is important to understand. Subsection (2) requires the lessor to hold for the lessee identified goods in the lessor's possession. Absent agreement to the contrary, whether in the lease or otherwise, under most circumstances the requirement that the lessor hold the goods for the lessee for the term will mean that the lessor is not allowed to use them. Sections 2A-103(4) and 1-203. Further, the lessor's use of the goods could be viewed as a disposition of the goods that would bar the lessor from recovery under this section, remitting the lessor to the two preceding sections for a determination of the lessor's claim for damages against the lessee.

6. Subsection (5), the analogue of subsection 2-709(3), further reinforces the thrust of subsection (3) by stating that a lessor who is held not entitled to rent under this section has not elected a remedy; the lessor must be awarded damages under Sections 2A-527 and 2A-528. This is a function of two significant policies of this Article — that resort to a remedy is optional, unless expressly agreed to be exclusive (Section 2A-503(2)) and that rights and remedies provided in this Article generally are cumulative. (Section 2A-501(2) and (4)).

Cross References:
Sections 1-203, 2-709, 2-709(3), 2A-103(4), 2A-501(2), 2A-501(4), 2A-503(2), 2A-504, 2A-523(1)(e), 2A-525(2), 2A-527, 2A-528 and 2A-529(2).

Definitional Cross References:
"Action". Section 1-201(1).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-102(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Reasonable time". Section 1-204(1) and (2).

§ 25-2A-530. Lessor's incidental damages.

Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care, and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-710.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 25-2A-531. Standing to sue third parties for injury to goods.

(1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract then (a) the lessor has a right of action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:
(i) has a security interest in the goods;
(ii) has an insurable interest in the goods; or
(iii) bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his suit or settlement, subject to his own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party, with the consent of the other, may sue for the benefit of whom it may concern. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-722.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).

§ 25-2A-532. Lessor's rights to residual interest.

In addition to any other recovery permitted by this Article or other law, the lessor may recover from the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

This section recognizes the right of the lessor to recover under this Article (as well as under other law) from the lessee for failure to comply with the lease obligations as to the condition of leased goods when returned to the lessor, for failure to return the goods at the end of the lease, or for any other default which causes loss or injury to the lessor's residual interest in the goods.

ARTICLE 3.

Negotiable Instruments.

(Revised)

NORTH CAROLINA COMMENT

This article is based upon Revised Article 3 of the Uniform Commercial Code (hereinafter "Revised Article 3").

Two types of comments appear. Under the designation "Official Comment" are the Official Comments of the National Conference of Commissioners on Uniform State Laws. Under the designation "North Carolina Comment" are comments designed to note North Carolina deviations from Revised Article 3. Therefore, only sections that deviate from Revised Article 3 have a North Carolina Comment.

Editor's Note. — Official Comments in Article 3: Copyright 1995 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1.

General Provisions and Definitions.

§ 25-3-101. Short title.

This Article may be cited as Uniform Commercial Code — Negotiable Instruments. (1899, c. 733, ss. 128, 191; Rev., ss. 2278, 2340; C.S., ss. 2976, 3110; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

Editor's Note. — Section 1 of Chapter 232 of Session Laws 1995, effective October 1, 1995, rewrote Article 3 of Chapter 25 of the Uniform Commercial Code. Historical citations and case annotations to sections in the former Article 3 have been added to corresponding sections in new Article 3 as recodified. At the end of Article 3 are tables showing comparable sections and their disposition in new Article 3.

Legal Periodicals. — For case law survey on negotiable instruments, see 41 N.C.L. Rev. 496 (1963).

For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For survey of 1982 commercial law, see 61 N.C.L. Rev. 1018 (1983).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For article, "The Legal Impact of the Federal Trade Commission's Holder in Due Course Notice on a Negotiable Instrument: How Clever Are the Rascals at the FTC?," see 68 N.C.L. Rev. 953 (1990).

CASE NOTES

Cited in Kane Plaza Assocs. v. Chadwick, 126 N.C. App. 661, 486 S.E.2d 465 (1997).

§ 25-3-102. Subject matter.

(a) This Article applies to negotiable instruments. It does not apply to money, to payment orders governed by Article 4A, or to securities governed by Article 8.

(b) If there is conflict between this Article and Article 4 or 9, Articles 4 and 9 govern.

(c) Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency. (1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 was a limitation on scope. In revised Article 3, Section 3-102 states that Article 3 applies to "negotiable instruments," defined in Section 3-104. Section 3-104(b) also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 uses the shorter term "instrument." This follows the convention used in former Article 3.

2. The reference in former Section 3-103(1) to "documents of title" is omitted as superfluous because these documents contain no promise to pay money. The definition of "payment order" in Section 4A-103(a)(1)(iii) excludes drafts which are governed by Article 3. Section 3-102(a) makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

Article 8 states in Section 8-102(1)(c) that "A writing that is a certificated security is governed by this Article and not by Article 3, even though it also meets the requirements of that Article." Section 3-102(a) conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3-104(a) or a certificated security under Section 8-102(1)(a). Whether a writing is covered by Article 3 or Article 8 has important consequences. Among other things, under Section 8-207, the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3-301. There are also important consequences to an indorser. An indorser of a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non-bearer form should be relatively clear. A certificated security under Article 8 must be in registered form (Section 8-102(1)(a)(i)) so that it can be registered on the issuer's records. By contrast, registration plays no part in Article 3. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8-102(1)(a)(iii)). Thus, a promissory note in bearer form could come under either Article 3 if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8-102(1)(a)(ii)). Thus, a check written in bearer form (i.e., a check made payable to "cash") would not be a certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 3-102(a).

3. Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3-102(c) states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. *Childs v. Federal Reserve Bank of Dallas,* 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3-102(c) treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. § 4007(b).

4. In *Clearfield Trust Co. v. United States,* 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In *United States v. Kimbell Foods, Inc.,* 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the *Kimbell* test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In *Kimbell* the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3-104 will not be governed by Article 3 if it is governed by the Convention.

CASE NOTES

I. General Consideration.

II. Decisions under Prior Version of Article 3.
III. Decisions under Prior Law.

I. GENERAL CONSIDERATION.

Cited in Futrelle v. Duke Univ., 127 N.C. App. 244, 488 S.E.2d 635 (1997); Thompson v. First Citizens Bank & Trust Co., 151 N.C. App. 704, 567 S.E.2d 184, 2002 N.C. App. LEXIS 889 (2002).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Subdivision (16) of § 1-52 was not meant to be applicable to specialized causes of action provided for in integrated statutory schemes such as found in Article 3 of Chapter 25. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

III. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Primary and Secondary Liability. — When a promissory note sued on has the signatures of two of the defendants on its face as joint makers and the other defendant's signature on the back as indorser, defendants are each liable to the payee and, nothing else appearing, those signing as makers are primarily liable, with the right of contribution among themselves, while the indorser is secondarily liable. Raleigh Trust Co. v. York, 199 N.C. 624, 155 S.E. 263 (1930).

Joint makers upon the face of a negotiable instrument are deemed to be primarily liable thereon. Roberson Co. v. Spain, 173 N.C. 23, 91 S.E. 361 (1917). See also, Taft v. Covington, 199 N.C. 51, 153 S.E. 597 (1930).

When a married woman has executed a note as co-maker with her husband, a holder in due course for value may accordingly enforce collection thereof against her as a person primarily liable on the note and absolutely required to pay it. Taft v. Covington, 199 N.C. 51, 153 S.E. 597 (1930).

§ 25-3-103. Definitions.

(a) In this Article:

(1) "Acceptor" means a drawee who has accepted a draft.

(2) "Drawee" means a person ordered in a draft to make payment.

(3) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.

(4) Repealed by Session Laws 2006-112, s. 12, effective October 1, 2006.

(5) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.

(6) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(7) "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this Article or Article 4.

(8) "Party" means a party to an instrument.

(9) "Promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(10) "Prove" with respect to a fact means to meet the burden of establishing the fact (G.S. 25-1-201(b)(8)).

(11) "Remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(b) Other definitions applying to this Article and the sections in which they appear are:

"Acceptance"	G.S. 25-3-409.
"Accommodated party"	G.S. 25-3-419.
"Accommodation party"	G.S. 25-3-419.
"Alteration"	G.S. 25-3-407.
"Anomalous indorsement"	G.S. 25-3-205.
"Blank indorsement"	G.S. 25-3-205.
"Cashier's check"	G.S. 25-3-104.
"Certificate of deposit"	G.S. 25-3-104.
"Certified check"	G.S. 25-3-409.
"Check"	G.S. 25-3-104.
"Consideration"	G.S. 25-3-303.
"Draft"	G.S. 25-3-104.
"Holder in due course"	G.S. 25-3-302.
"Incomplete instrument"	G.S. 25-3-115.
"Indorsement"	G.S. 25-3-204.
"Indorser"	G.S. 25-3-204.
"Instrument"	G.S. 25-3-104.
"Issue"	G.S. 25-3-105.
"Issuer"	G.S. 25-3-105.
"Negotiable instrument"	G.S. 25-3-104.
"Negotiation"	G.S. 25-3-201.
"Note"	G.S. 25-3-104.
"Payable at a definite time"	G.S. 25-3-108.
"Payable on demand"	G.S. 25-3-108.
"Payable to bearer"	G.S. 25-3-109.
"Payable to order"	G.S. 25-3-109.
"Payment"	G.S. 25-3-602.
"Person entitled to enforce"	G.S. 25-3-301.
"Presentment"	G.S. 25-3-501.
"Reacquisition"	G.S. 25-3-207.
"Special indorsement"	G.S. 25-3-205.
"Teller's check"	G.S. 25-3-104.
"Transfer of instrument"	G.S. 25-3-203.
"Traveler's check"	G.S. 25-3-104.
"Value"	G.S. 25-3-303.

(c) The following definitions in other Articles apply to this Article:

"Bank"	G.S. 25-4-105.
"Banking day"	G.S. 25-4-104.
"Clearing house"	G.S. 25-4-104.
"Collecting bank"	G.S. 25-4-105.
"Depositary bank"	G.S. 25-4-105.
"Documentary draft"	G.S. 25-4-104.
"Intermediary bank"	G.S. 25-4-105.
"Item"	G.S. 25-4-104.
"Payor bank"	G.S. 25-4-105.
"Suspends payments"	G.S. 25-4-104.

(d) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1899, c. 733, ss. 17, 68; Rev., ss. 1952, 2217, 2341; C.S., ss. 2998, 3049; 1965, c. 700, s. 1; 1995, c. 232, s. 1; 2006-112, ss. 12, 13.)

OFFICIAL COMMENT

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3-102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier's check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3-118(a) treated a cashier's check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier's check as a promise by the issuing bank to pay rather than an order to pay, a cashier's check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section 3-412.

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3-501(b)(1) provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgement of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. Subsection (a)(4) introduces a definition of good faith to apply to Articles 3 and 4. Former Articles 3 and 4 used the definition in Section 1-201(19). The definition in subsection (a)(4) is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4-104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant business prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4-406 and it is discussed in Comment 4 to that section. Nothing in Section 3-103(a)(7) is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. In subsection (c) reference is made to a new definition of "bank" in amended Article 4.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 12 and 13, effective October 1, 2006, repealed subdivision (a)(4), which read: "'Good faith' means honesty in fact and the observance of reasonable commercial standards of fair dealing."; and substituted "(G.S. 25-1-201(b)(8))" for "(G.S. 25-1-201(8))" in subdivision (a)(10).

CASE NOTES

Good Faith. — Presenting bank was not entitled to assert a lack of good faith defense to breach of warranty claims brought against it by a paying bank with respect to an altered check; the paying bank's failure to investigate after payment of the check was irrelevant to its good faith in paying the check, and the failure of the bank's processing procedures to detect the alteration did not amount to dishonesty or unfair dealing. Wachovia Bank, N.A. v. FRB, 338 F.3d 318, 2003 U.S. App. LEXIS 15014 (4th Cir. 2003).

§ 25-3-104. Negotiable instrument.

(a) Except as provided in subsections (c) and (d) of this section, "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(1) Is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) Is payable on demand or at a definite time; and

(3) Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "Instrument" means a negotiable instrument.

(c) An order that meets all of the requirements of subsection (a) of this section, except subdivision (1), and otherwise falls within the definition of "check" in subsection (f) is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this Article.

(e) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument falls within the definition of both "note" and "draft", a person entitled to enforce the instrument may treat it as either.

(f) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as "money order".

(g) "Cashier's check" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) "Teller's check" means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "Traveler's check" means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) "Certificate of deposit" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank. (1899, c. 733, ss. 1, 2, 5, 6, 10, 17, 86, 126, 184, 185, 197; 1905, c. 327; Rev., ss. 1952, 2151, 2152, 2154, 2155, 2160, 2217, 2276, 2334, 2335, 2341, 2346; C.S., ss. 2982, 2983, 2986, 2987, 2991, 2998, 3049, 3108, 3166, 3167; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section 3-102 states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) incorporates other definitions in Article 3. An instrument is either a "promise," defined in Section 3-103(a)(9), or "order," defined in Section 3-103(a)(6). A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of money. "Money" is defined in Section 1-201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3-104(a): First, the promise or order must be "unconditional." The quoted term is explained in Section 3-106. Second, the amount of money must be "a fixed amount *** with or without interest or other charges described in the promise or order." Section 3-112(b) relates to "interest." Third, the promise or order must be "payable to bearer or to order." The quoted phrase is explained in Section 3-109. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section 3-108. Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3-104(a)(3) are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. G.S. 5(1), (2), and (3). Subsection (b) states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) applies, the effect of subsection (a)(1) and Section 3-102(a) is to exclude from Article 3 any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 that is comparable to former Section 3-805. The Comment to former Section 3-805 states that the typical example of a writing covered by that section is a check reading "Pay John Doe." Such a check was governed by former Article 3 but there could not be a holder in due course of the check. Under Section 3-104(c) such a check is governed by revised Article 3 and there can be a holder in due course of the check. But subsection (c) applies only to checks. The Comment to former Section 3-805 does not state any example other than the check to illustrate that section. Subsection (c) is based on the belief that it is good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words "to the order of". These words are almost always pre-printed on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that the writing is a negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 because of the requirements of Section 3-104(a) may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3-104 or in Section 3-102 is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3-104(a) is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case #2 in Comment 4 to Section 3-302.

Moreover, consistent with the principle stated in Section 1-102(2)(b), the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 determine their rights and obligations under the writing. Upholding the parties' choice is not inconsistent with Article 3. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) allows exclusion from Article 3 of a writing that would otherwise be an instrument under subsection (a) by a statement to the effect that the writing is not negotiable or is not governed by Article 3. For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsection (d) is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) does not, however, apply to a check. If a writing is excluded from Article 3 by subsection (d), a court could, nevertheless, apply Article 3 principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3-104(e). The term "bill of exchange" is not used in Article 3. It is generally understood to be a synonym for the term "draft." Subsections (f) through (j) define particular instruments that fall within the categories of draft and note. The term "draft," defined in subsection (e), includes a "check" which is defined in subsection (f). "Check" includes a share draft drawn on a credit union payable through a bank because the definition of bank (Section 4-105*) includes credit unions. However, a draft drawn on an insurance company payable through a bank is not a check because it is not drawn on a bank. "Money orders" are sold both by banks and non-banks. They vary in form and their form determines how they are treated in Article 3. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 and is subject to a stop order by the purchaser-drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller's check, the rules applicable to teller's checks apply. Postal money orders are subject to federal law. "Teller's check" is separately defined in subsection (h). A teller's check is always drawn by a bank and is usually drawn on another bank. In some cases a teller's check is drawn on a nonbank but is made payable at or through a bank. Article 3 treats both types of teller's check identically, and both are included in the definition of "check." A cashier's check, defined in subsection (g), is also included in the definition of "check." Traveler's checks are issued both by banks and non-banks and may be in the form of a note or draft. Subsection (i) states the essential characteristics of a traveler's check. The requirement that the instrument be "drawn on or payable at or through a bank" may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC G.S. 229.2 of the terms "check," "cashier's check," "teller's check," and "traveler's check" are different from the definitions of those terms in Article 3.

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3, Section 3-104(j) treats them as notes.

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*Previous incorrect cross reference corrected by Permanent Editorial Board action November 1992.

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Version of Article 3.
III. Decisions under Prior Law.

I. GENERAL CONSIDERATION.

Promissory Note. — Where promissory note was issued as payment of an antecedent claim (old loans) and in exchange for the cancellation of such loans as set forth in subdivisions (a)(1) and (a)(3), the promissory note was supported by consideration as a matter of law. Franklin Credit Recovery Fund v. Huber, 127 N.C. App. 187, 487 S.E.2d 825 (1997), cert. denied, 347 N.C. 398, 494 S.E.2d 411 (1997).

A promissory note was not a negotiable instrument where it did not state that it was payable on demand or at definite time. Barclays Bank v. Johnson, 129 N.C. 370, 499 S.E.2d 768 (1998).

Nonbankrupt Wife Remained Liable Under Note That Was Partly Reaffirmed by Bankrupt Husband. — Promissory note was subject to the Uniform Commercial Code as complying with all of the provisions under G.S. 25-3-104(a)(1)-(3) and not conspicuously stating it was not negotiable, so the nonbankrupt wife remained liable under G.S. 25-3-604(a), since the bank did not release her in a "signed" writing as part of the bankrupt husband's agreement to reaffirm part of defaulted note's debt so that he could keep the collateral that was titled only in his name. First Commerce Bank v. Dockery, 171 N.C. App. 297, 615 S.E.2d 314, 2005 N.C. App. LEXIS 1202 (2005).

Cited in Futrelle v. Duke Univ., 127 N.C. App. 244, 488 S.E.2d 635 (1997).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Not a Negotiable Instrument. — Under G.S.25-3-104(d), the certificate of deposit was not a negotiable instrument governed by the Uniform Commercial Code, because the certificate of deposit confirmation stated conspicuously in capital letters that the certificate of deposit was non-transferable. Thompson v. First Citizens Bank & Trust Co., 151 N.C. App. 704, 567 S.E.2d 184, 2002 N.C. App. LEXIS 889 (2002).

The full tests for determining whether a particular instrument is a negotiable instrument under this Article can be determined only by reading G.S. 25-3-104 through 25-3-112 as a unit. Booker v. Everhart, 294 N.C. 146, 240 S.E.2d 360 (1978).

Effect of Condition in Instrument. — Under the law of this State prior to the adoption of the UCC, it was clearly established that a conditional promise or contingent condition contained in the instrument itself had the effect of defeating the negotiability of the instrument. This prior law is carried forward in subsection (1)(b). Booker v. Everhart, 294 N.C. 146, 240 S.E.2d 360 (1978).

Reference to Mortgage, Liens or Collateral. — A promise is not unconditional if the instrument containing it states that it is subject to or governed by any other agreement or writing. But referring to a mortgage or other collateral does not impair negotiability. Nor does incorporating into a note the liens that secure its payment. Mere liens securing payment of a debt cannot affect the obligation to pay it. International Minerals & Chem. Corp. v. Matthews, 71 N.C. App. 209, 321 S.E.2d 545 (1984), cert. denied, 313 N.C. 330, 327 S.E.2d 890 (1985).

Note Not Payable to Order or Bearer. — A draft is not a negotiable instrument when it is payable to two named payees without the addition of the words "or order," or any similar words of negotiability. First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

Article 3 of the UCC applies to a nonnegotiable draft payable to two named payees without the addition of the words "or order" or any similar words of negotiability, except that no holder of it can be a holder in due course. First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

Under old law of commercial paper and now incorporated into the UCC, a note payable neither to order nor to bearer is not negotiable. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

Certificate of deposit "payable to the Registered Holder, or to the duly registered assignee hereof" was not payable to order or bearer and thus lacked the essential words of negotiability. Furthermore, the certificate contained terms precluding transfer and was nonnegotiable because there was no unconditional promise to pay. Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

Specificity on the face of the negotiable instrument is required, whether payment be to order or to bearer. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

The payee's name is not one of the terms and omissions not affecting negotiability under this section. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

A traveler's check is a negotiable instrument within the purview of this Article. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

A continuing guaranty was not a negotiable instrument where it provided a ceiling on the amount of defendant's liability but did not specify the amount of liability that was to be paid, and where there was no provision in the agreement that it was payable to order or bearer. Branch Banking & Trust Co. v. Creasy, 301 N.C. 44, 269 S.E.2d 117 (1980).

Reason for Definite Sum. — It is necessary for a negotiable instrument to bear a definite sum so that subsequent holders may take and transfer the instrument without having to plumb the intricacies of the instrument's background. Branch Banking & Trust Co. v. Creasy, 301 N.C. 44, 269 S.E.2d 117 (1980).

For the requirement of a sum certain to be met, it is necessary that at the time of payment the holder is able to determine the amount which is then payable from the instrument itself, with any necessary computation, without any reference to an outside source. Branch Banking & Trust Co. v. Creasy, 301 N.C. 44, 269 S.E.2d 117 (1980).

Agreement Establishing Only Ceiling on Liability. — An agreement signed by defendant which guaranteed the payment of "any and all indebtedness, liabilities and obligations of every nature and kind of said debtor to the extent of $30,000" was not a negotiable instrument since it did not contain an unconditional promise to pay a sum certain but only established a ceiling on the amount of the guarantor's liability. Gillespie v. DeWitt, 53 N.C. App. 252, 280 S.E.2d 736, cert. denied, 304 N.C. 390, 285 S.E.2d 832 (1981).

In light of the prevailing commercial practices and the purpose of the Uniform Commercial Code (U.C.C.), there exists no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

Purchase money security agreement signed by guarantor was not a negotiable instrument because it contained a number of promises in addition to an unconditional promise or order to pay a certain sum. Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

Interpretation of Negotiable Instrument. — Where the promissory note is a negotiable instrument within the meaning of this section, interpretation of the note is governed by the provisions therein. Smith v. Rushing Constr. Co., 84 N.C. App. 692, 353 S.E.2d 692 (1987).

III. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Provision for Attorneys' Fees. — Before the NIL was enacted, a provision for attorneys' fees and exchange made note nonnegotiable because of uncertainty of the amount to be paid. First Nat'l Bank v. Bynum, 84 N.C. 24 (1881).

By amendment to the NIL, a provision was inserted by the legislature of this State so that, in accordance with the uniform law, a stipulation for attorneys' fees did not destroy the negotiability of the instrument, but the stipulation was not enforceable. See the North Carolina Comment to this section. It was the evident policy of the legislature to prevent any stipulation permitting "collection fees," as being against public policy. Turner v. Boger, 126 N.C. 300, 35 S.E. 592 (1900).

An application of the operation of this provision will be found in Security Fin. Co. v. Hendry, 189 N.C. 549, 127 S.E. 629 (1925).

Since a provision for collection fees was invalid it did not affect the amount in suit in determining the jurisdiction of a justice court. Exchange Bank v. Appalachian Land & Lumber Co., 128 N.C. 193, 38 S.E. 813 (1901).

Since attorneys' fees were not collectible under the NIL, as amended, an agent with special authority to pay a note due out of fund held by him was limited to a payment of the principal sum, interests and costs that had accrued at the time of payment. Hooper v. Merchants' Bank & Trust Co., 190 N.C. 423, 130 S.E. 49 (1925).

Foreign Contract for Attorneys' Fees. — The validity of a provision in a note for attorneys' fees executed and payable in Georgia must be determined by the laws of North Carolina. Exchange Bank v. Appalachian Land & Lumber Co., 128 N.C. 193, 38 S.E. 813 (1901).

Because of former G.S. 25-8 of the NIL, the courts of North Carolina would not enforce such a provision. Security Fin. Co. v. Hendry, 189 N.C. 549, 127 S.E. 629 (1925).

A contingent condition has always defeated the negotiability of an instrument. Goodloe v. Taylor, 10 N.C. 458 (1825).

After the passage of the NIL, the court held that a note, the payment of which was made dependent upon a condition expressed in a separate instrument, a deed, was not negotiable. Pope v. Righter Parey Lumber Co., 162 N.C. 206, 78 S.E. 65 (1913).

Thus, Conditional Promise or Uncertain Sum Renders Note Nonnegotiable. — To render a note nonnegotiable it must show on its face that the promise to pay is conditional or must render the amount to be paid uncertain. First Nat'l Bank v. Michael, 96 N.C. 53, 1 S.E. 855 (1887).

Note Not Payable to Order or Bearer Is Not Negotiable. — A note not payable to order or bearer is not a negotiable paper. Newland v. Moore, 173 N.C. 728, 92 S.E. 367 (1917).

Unless a note is payable to the order of a special person or to bearer it is not negotiable. Johnson v. Lassiter, 155 N.C. 47, 71 S.E. 23 (1911).

Where an instrument is expressly made payable to a named person, such a provision clearly imports a lack of negotiability under this section. Bank of United States v. Cuthbertson, 67 F.2d 182 (4th Cir. 1933), cert. denied, 291 U.S. 665, 54 S. Ct. 441, 78 L. Ed. 1056 (1934).

The absence of the words "to bearer" or "to order" does not render bonds nonassignable, but nonnegotiable. Bank of United States v. Cuthbertson, 67 F.2d 182 (4th Cir. 1933), cert. denied, 291 U.S. 665, 54 S. Ct. 441, 78 L. Ed. 1056 (1934).

But note payable to a specific person or his order is negotiable. Price Real Estate & Ins. Co. v. Jones, 191 N.C. 176, 131 S.E. 587 (1926).

As to certainty of amount to be paid and time of payment, see First Nat'l Bank v. Bynum, 84 N.C. 24 (1881).

As to necessity of payment in money, see Johnson v. Henderson, 76 N.C. 227 (1877).

Restriction as to Payment. — A stipulation stamped on the face of a check, to the effect that it will positively not be paid to a certain company or its agents, is a valid restriction and is binding on the holder. Commercial Nat'l Bank v. First Nat'l Bank, 118 N.C. 783, 24 S.E. 524 (1896).

The recital on the face of a note, to wit: "This is one of a series of notes secured by deed of trust or mortgage," did not affect the negotiable character of the notes under the NIL. Walter v. Kilpatrick, 191 N.C. 458, 132 S.E. 148 (1926).

Foreign Waiver of Homestead. — A provision in a note for the waiver of homestead exemption will not be enforced by the courts of this State although the note may have been executed by parties in another state. Exchange Bank v. Appalachian Land & Lumber Co., 128 N.C. 193, 38 S.E. 813 (1901).

As to an instrument written in pencil, see Gudger v. Fletcher, 29 N.C. 372 (1847).

Bill of Exchange. — Where a draft drawn to the maker's order, having been indorsed by another, is accepted at a bank and is then purchased in due course before maturity by an innocent purchaser for value, the bank may not resist payment upon the ground that the transaction was ultra vires and not within the authority of its charter authorizing it to accept bills, notes, commercial paper, etc., for it comes within the NIL definition of an inland bill of exchange. Sherrill v. American Trust Co., 176 N.C. 591, 97 S.E. 471 (1918).

A check is an instrument by which a depositor seeks to withdraw funds from a bank. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

A check is defined as a written order on a bank or banker, purporting to be drawn against a deposit of funds, for the payment at all events of a sum of money to a certain person therein named, or to him or his order, or to bearer, and payable on demand. Woody v. First Nat'l Bank, 194 N.C. 549, 140 S.E. 150 (1927).

A check is a contract within itself, and it is equivalent to the drawer's promise to pay the payee or holder. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

By the act of drawing and delivering a check to the payee, the drawer commits himself to pay the amount of the check in the event the drawee refuses payment upon presentment. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

A check is an order to the bank on which it is drawn to pay the amount thereof and charge it to the drawer's account. In respect of a check, the bank on which it is drawn is the drawee, and when presented to the drawee the provisions of the NIL as to the time allowed a drawee to accept a bill applied. Branch Banking & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961).

There is little difference between a check and a demand note, as a practical matter, in business transactions; both are acknowledgments of indebtedness and an unconditional promise to pay. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

As to certificates of deposit, see Johnson v. Henderson, 76 N.C. 227 (1877).

Bond. — A bond is in form negotiable, and when indorsed for value and without notice before maturity it is to be regarded, so far as its negotiability is concerned and its liability to be governed by the commercial law applicable to promissory notes, as if it were a promissory note not under seal. Miller v. Tharel, 75 N.C. 148 (1876); Spence v. Tabscott, 93 N.C. 246 (1885). The principle was applied in Lewis v. Young, 102 N.C. 206, 9 S.E. 637 (1989), in which it was decided that an obligor on a bond could not, as against an indorsee for value, before maturity and without notice, set up the defense that he executed the same as a surety only. Christian v. Parrott, 114 N.C. 215, 19 S.E. 151 (1894).

Provisions that a bond should be payable to bearer, or if registered to the registered holder only, and provisions for an extension of time, upon application of the maker, in the discretion of the trustee in the deed of trust securing it, did not change its negotiable character. Thomas v. De Moss, 202 N.C. 646, 163 S.E. 759 (1932).

A municipal bond payable to bearer, and otherwise complying as to form with the provisions of the NIL, was a negotiable instrument, and as such when in the hands of a holder in due course was not subject to defenses which would otherwise ordinarily be available to the municipal corporation by which the bond was issued. Bankers' Trust Co. v. City of Statesville, 203 N.C. 399, 166 S.E. 169 (1932).

A bond indemnifying a bank from any loss which it might sustain by reason of its taking over the assets and discharging the liabilities of another bank, the bond being payable to the liquidating bank and not to its order, was not a negotiable instrument within the meaning of the NIL. North Carolina Bank & Trust Co. v. Williams, 201 N.C. 464, 160 S.E. 484 (1931).

County Warrant. — Although county warrants are transferable by indorsement, and the indorsee or holder may sue upon them in his own name, they are not negotiable in the sense that the holder in due course was protected by the NIL. Wright v. Kinney, 123 N.C. 618, 31 S.E. 874 (1898).

Due Bill. — See Purtel v. Morehead, 19 N.C. 239 (1837).

Unsigned Travelers' Check. — A travelers' check not signed or countersigned by the purchaser or holder is not a negotiable instrument, since it is not an unconditional promise to pay to the order of a specified person or bearer, the promise to pay being conditioned upon the check being countersigned with the signature appearing at the top of the check. Venable v. American Express Co., 217 N.C. 548, 8 S.E.2d 804 (1940).

Seal. — The fact that an instrument is under seal does not affect its negotiability. First Nat'l Bank v. Michael, 96 N.C. 53, 1 S.E. 855 (1887). See also, Pate v. Brown, 85 N.C. 166 (1881).

The lack of consideration cannot benefit a maker of a bond under seal because the law conclusively presumes that it was made upon good and sufficient consideration. Angier v. Howard, 94 N.C. 27 (1886); Wester v. Bailey, 118 N.C. 193, 24 S.E. 9 (1896).

OPINIONS OF ATTORNEY GENERAL

Distinction Between "Check" and "Draft". — See opinion of Attorney General to Mr. Fred P. Parker, Jr., Wayne County Attorney, 40 N.C.A.G. 817 (1969).

§ 25-3-105. Issue of instrument.

(a) "Issue" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(b) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) "Issuer" applies to issued and unissued instruments and means a maker or drawer of an instrument. (1899, c. 733, ss. 16, 28, 58, 59; Rev., ss. 2166, 2176, 2207, 2208; C.S., ss. 2997, 3008, 3039, 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In revised Article 3, Section 3-105(a) defines "issue" more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. "Delivery" with respect to instruments is defined in Section 1-201(14) as meaning "voluntary transfer of possession."

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a

holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) defines "issuer" to include the signer of an unissued instrument for convenience of reference in the statute.

§ 25-3-106. Unconditional promise or order.

(a) Except as provided in this section, for the purposes of G.S. 25-3-104(a), a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(b) A promise or order is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of G.S. 25-3-104(a). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of G.S. 25-3-104(a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument. (1899, c. 733, s. 3; Rev., s. 2153; C.S., s. 2984; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This provision replaces former Section 3-105. Its purpose is to define when a promise or order fulfills the requirement in Section 3-104(a) that it be an "unconditional" promise or order to pay. Under Section 3-106(a) a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to the order of John Doe if he conveys title to Blackacre to me." The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title to Blackacre I promise to pay $100,000 to the order of John Doe." That promise can be an instrument if Section 3-104 is otherwise satisfied. Although the recital of the executory promise of Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3-106(a)(i). This result is consistent with former Section 3-105(1)(a) and (b). Former Section 3-105(1)(b) is not repeated in Section 3-106 because it is not necessary. It is an example of an implied condition. Former Section 3-105(1)(d), (e), and (f) and the first clause of former Section 3-105(1)(c) are other examples of implied conditions. They are not repeated in Section 3-106 because they are not necessary. The law is not changed.

Section 3-106(a)(ii) and (iii) carry forward the substance of former Section 3-105(2)(a). The only change is the use of "writing" instead of "agreement" and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3-104 if it contains any of the following statements: 1. "This note is subject to a contract of sale dated April 1, 1990 between the payee and maker of this note." 2. "This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note." 3. "Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note." It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3-104(a)(3) and Section 3-108(b). In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: “This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement.” The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b). Under Section 3-106(a) a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instruments of this kind. If potential buyers don’t want promises or orders that are payable only from a particular source or fund, they won’t take them, but Article 3 should apply.

2. Subsection (c) applies to traveler’s checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler’s checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3. The first sentence of subsection (c) allows a traveler’s check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of Section 3-104. The second sentence states the effect of a failure to meet the condition. Suppose a thief steals a traveler’s check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler’s check becomes a holder when the traveler’s check is taken. The forged countersignature is a defense to the obligation of the issuer to pay the instrument, and is included in defenses under Section 3-305(a)(2). These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler’s check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers’ claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3. Most of the provisions of Article 3 are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if holder-in-due-course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3-104(a) it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from

that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

Legal Periodicals. — For note on contractual allocation of attorneys' fees as costs of litigation, see 17 Wake Forest L. Rev. 457 (1981).

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Reference to Separate Agreement. — Under former G.S. 25-3-105(1)(b) and (c), it is clear that mere reference in a note to the separate agreement or document out of which the note arises does not affect the negotiability of the note. But to go beyond a reference to the separate agreement, by incorporating the terms of that agreement into the note, makes the note "subject to or governed by" that agreement, and thus, under subsection (2)(a), renders the promise conditional and the note nonnegotiable. Booker v. Everhart, 294 N.C. 146, 240 S.E.2d 360 (1978).

When the instrument itself makes express reference to an outside agreement, transaction or document, the effect on the negotiability of the instrument will depend on the nature of the reference. Booker v. Everhart, 294 N.C. 146, 240 S.E.2d 360 (1978).

Where a promissory note provided that the terms of a collateral agreement were incorporated therein by reference, the promissory note was conditional and therefore not a negotiable instrument. Almond v. Rhyne, 108 N.C. App. 605, 424 S.E.2d 231 (1993).

Reference to Mortgage, Liens or Collateral. — A promise is not unconditional if the instrument containing it states that it is subject to or governed by any other agreement or writing. But referring to a mortgage or other collateral does not impair negotiability. Nor does incorporating into a note the liens that secure its payment. Mere liens securing payment of a debt cannot affect the obligation to pay it. International Minerals & Chem. Corp. v. Matthews, 71 N.C. App. 209, 321 S.E.2d 545 (1984), cert. denied, 313 N.C. 330, 327 S.E.2d 890 (1985).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Statement of Transaction. — A negotiable instrument, setting out the transaction for which the instrument is given, cannot be set aside when a holder in due course takes without notice of the infirmity or defect, where there is nothing in such contract to restrict negotiability in the instrument or to indicate fraud or an existent breach. First Nat'l Bank v. Michael, 96 N.C. 53, 1 S.E. 855 (1887); Bank of Sampson v. Hatcher, 151 N.C. 359, 66 S.E. 308 (1909).

§ 25-3-107. Instrument payable in foreign money.

Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid. (1899, c. 733, s. 6; Rev., s. 2155; C.S., s. 2987; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

The definition of instrument in Section 3-104 requires that the promise or order be payable in "money." That term is defined in Section 1-201(24) and is not limited to United States dollars. Section 3-107 states than an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3-107(1) to instruments payable in "currency" or "current funds" has been dropped as superfluous.

§ 25-3-108. Payable on demand or at definite time.

(a) A promise or order is "payable on demand" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A promise or order is "payable at a definite time" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(c) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date. (1899, c. 733, ss. 4, 7; Rev., ss. 2156, 2157; C.S., ss. 2985, 2988; 1923, c. 72; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section is a restatement of former Section 3-108 and Section 3-109. Subsection (b) broadens former Section 3-109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) restates former Section 3-109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Version of Article 3.
II. Decisions Under Prior Law.

I. GENERAL CONSIDERATION.

Cited in Mrozek v. Mrozek, 129 N.C. App. 43, 496 S.E.2d 836 (1998).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

A note stating that it was due at request with 30 days' notice was a demand note. Shields v. Prendergast, 36 N.C. App. 633, 244 S.E.2d 475 (1978).

A loan made on oral terms before the parties agree as to the time and manner of repayment is payable within a reasonable time rather than on demand, and the plaintiff has the burden of showing that a reasonable time for repayment has expired. Helms v. Prikopa, 51 N.C. App. 50, 275 S.E.2d 516 (1981).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under former statutory provisions.*

Statute of Limitations. — A promissory note, payable on demand, is due immediately, and the statute of limitations runs from that date. Caldwell v. Rodman, 50 N.C. 139 (1857), decided under former statutory provisions. The same is true of a bond when no time is specified for payment of it. Ervin v. Brook, 111 N.C. 358, 16 S.E. 240 (1892).

Acceleration Clause Did Not Prevent Negotiability. — Acceleration of the maturity of a note or of notes in a series, as the result of the failure of the maker to pay interest or to pay one of the notes of said series, when same became due, according to the tenor of the note or notes, by virtue of an agreement to that effect appearing on the face of the note or notes, did not make the note or notes of the series payable upon a contingency and therefore nonnegotiable within the meaning of the NIL. Newbern Banking & Trust Co. v. Duffy, 153 N.C. 62, 68 S.E. 915 (1910); Walter v. Kilpatrick, 191 N.C. 458, 132 S.E. 148 (1926).

Nor did agreement to be bound notwithstanding extension. First Nat'l Bank v. Johnson, 169 N.C. 526, 86 S.E. 360 (1912).

§ 25-3-109. Payable to bearer or to order.

(a) A promise or order is payable to bearer if it:

(1) States that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) Does not state a payee; or

(3) States that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to G.S. 25-3-205(a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to G.S. 25-3-205(b). (1899, c. 733, ss. 8, 9; Rev., ss. 2158, 2159; C.S., ss. 2989, 2990; 1949, c. 953; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Under Section 3-104(a), a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3-104(c) applies. The terms "payable to bearer" and "payable to order" are defined in Section 3-109. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3-201(b). An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3-201(b). An instrument payable to order is payable to an identified person. Section 3-109(b). Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words "to the order of" printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word "bearer" or "cash," the check reads "to the order of bearer" or "to the order of cash." In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee "John Doe" but will add the words "or bearer." In that case the check is payable to bearer. Subsection (a). Under subsection (b), if an instrument is payable to bearer it can't be payable to order. This is different from former Section 3-110(3). An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3-115. Subsection (a)(3) contains the words "otherwise indicates that it is not payable to an identified person." The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to "cash." The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as "ABC Corporation" if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not

payable to bearer. Negotiation of such an instrument is governed by Section 3-404(b).

CASE NOTES

Editor's Note. *— Most of the cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Specificity on the face of a negotiable instrument is required whether payment be to order or to bearer. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

A promissory note was not a negotiable instrument where it did not state that it was payable on demand or at definite time. Barclays Bank v. Johnson, 129 N.C. 370, 499 S.E.2d 768 (1998).

Draft Payable to Payees Without Addition of Word "or Order," etc. — A draft is not a negotiable instrument when it is payable to two named payees without the addition of the words "or order" or any similar words of negotiability. First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

There is no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

Ownership of Note upon Death of Joint Payee. — Promissory note payable only to testator and his wife did not become part of testator's estate but became the sole property of testator's wife upon his death; therefore, son would not inherit. Miller v. Miller, 117 N.C. App. 71, 450 S.E.2d 15 (1994).

§ 25-3-110. Identification of person to whom instrument is payable.

(a) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(b) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(c) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(1) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(2) If an instrument is payable to (i) a trust, an estate, or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named, (ii) a person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative, (iii) a fund or organization that is not a legal entity, the instrument is

payable to a representative of the members of the fund or organization, or (iv) an office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively. (1899, c. 733, ss. 8, 41, 42; Rev., ss. 2158, 2190, 2191; C.S., ss. 2989, 3022, 3023; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-110 states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an indorsement in the name of the payee. Subsection (a) states the general rule that the person to whom an instrument is payable is determined by the intent of "the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument." "Issuer" means the maker or drawer of the instrument. Section 3-105(c). If X signs a check as drawer of a check on X's account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y's signature as drawer of a check, the intent of X also controls. Under Section 3-103(a)(3), Y is referred to as the drawer of the check because the signing of Y's name identifies Y as the drawer. But since Y's signature was forged Y has no liability as drawer (Section 3-403(a)) unless some other provision of Article 3 or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to "John Smith" since there are many people in the world named "John Smith" it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a), but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person known to the drawer as John Smith. In fact that person's name is James Smith or John Jones or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person's correct name or in both names. Section 3-204(d). The intent of the drawer is also controlling in fictitious payee cases. Section 3-404(b). The last sentence of subsection (a) refers to rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check-writing machine. In that case, the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check-writing machine is likely to be operated by means of a computer in which is stored information as to name and address of the payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3-404(b) is also concerned with this issue. See Case #4 in Comment 2 to Section 3-404.

2. Subsection (c) allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) relates to instruments payable to bank accounts. In some cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to "X Corporation Account No. 12345 in Bank of Podunk." Under the last sentence of subsection (c)(1), this check is payable to X Corporation and can be negotiated by X Corpo-

ration even if Account No. 12345 is some other person's account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) the check is payable to Creditor and, under Section 1-201(20), Creditor becomes the holder when the check is delivered. Under Section 3-201(b), further negotiation of the check requires the indorsement of Creditor. But under Section 4-205(a), if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3-102(b), provisions of Article 4 prevail over those of Article 3. The depositary bank warrants that the amount of the check was credited to the payee's account.

3. Subsection (c)(2) replaces former Section 3-117 and subsections (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) replaces former Section 3-116. An instrument payable to X or Y is governed by the first sentence of subsection (d). An instrument payable to X and Y is governed by the second sentence of subsection (d). If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3-301. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is "payable to an identified person." The "identified person" is X and Y acting jointly. Section 3-109(b) and Section 1-102(5)(a). Thus, under Section 1-201(20) X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement of a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

Cross References. — For definition of "organization," see G.S. 25-1-201 (28).

CASE NOTES

I. General Consideration.
II. Decisions under Prior Version of Article 3.

I. GENERAL CONSIDERATION.

Claim Improperly Dismissed. — Where collateral writing met the requirements of subsection (a) (See now 25-3-110(c)(2)(ii)) for describing instrument made payable to agent of a specified person, the trial court erred in dismissing claim seeking payment from defendants. Kane Plaza Assocs. v. Chadwick, 126 N.C. App. 661, 486 S.E.2d 465 (1997).

Cited in Upchurch v. Upchurch, 122 N.C. App. 172, 468 S.E.2d 61 (1996), review denied, 343 N.C. 517, 472 S.E.2d 26 (1996).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Ownership of Note upon Death of Joint Payee. — Promissory note payable only to testator and his wife did not become part of testator's estate but became the sole property of testator's wife upon his death; therefore, son would not inherit. Miller v. Miller, 117 N.C. App. 71, 450 S.E.2d 15 (1994).

§ 25-3-111. Place of payment.

Except as otherwise provided for items in Article 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker. (1899, c. 733, ss. 72, 73, 77, 78, 145; Rev., ss. 2221, 2222, 2226, 2227, 2295; C.S., ss. 3053, 3054, 3058, 3059, 3127; 1963, c. 242; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

If an instrument is payable at a bank in the United States, Section 3-501(b)(1) states that presentment must be made at the place of payment, i.e. the bank. The place of presentment of a check is governed by Regulation CC G.S. 229.36.

§ 25-3-112. Interest.

(a) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues. (1899, c. 733, ss. 17, 68; Rev., ss. 1952, 2217, 2341; C.S., ss. 2998, 3049; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Under Section 3-104(a) the requirement of a "fixed amount" applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgment rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) replaces subsection (d) of former Section 3-118.

2. The purpose of subsection (b) is to clarify the meaning of "interest" in the introductory clause of Section 3-104(a). It is not intended to validate a provision for interest in an instrument if that provision violates other law.

§ 25-3-113. Date of instrument.

(a) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in G.S. 25-4-401(c), an instrument payable on demand is not payable before the date of the instrument.

(b) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

(1899, c. 733, ss. 6, 11, 12, 17; Rev., ss. 1952, 2155, 2161, 2162, 2341; C.S., ss. 2987, 2992, 2993, 2998; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section replaces former Section 3-114. Subsections (1) and (3) of former Section 3-114 are deleted as unnecessary. Section 3-113(a) is based in part on subsection (2) of former Section 3-114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4-401(c) which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

§ 25-3-114. Contradictory terms of instrument.

If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers. (1899, c. 733, ss. 17, 68; Rev., ss. 1952, 2217, 2341; C.S., ss. 2998, 3049; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-114 replaces subsections (b) and (c) of former Section 3-118.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Former § 25-3-118(e) did not change the rule in this State that a prior indorser is not entitled to recover from a subsequent indorser in the absence of an agreement otherwise establishing liability. Wilson v. Turner, 29 N.C. App. 101, 223 S.E.2d 539, cert. denied, 290 N.C. 311, 225 S.E.2d 832 (1976).

Revealing Parties' True Relationship. — The true relationship existing between the parties may be revealed to alter the otherwise absolute obligation of the signers. Grimes v. Grimes, 47 N.C. App. 353, 267 S.E.2d 372 (1980).

Comaker's Right to Contribution. — Because of the joint and several nature of a maker's obligation under a note, when one comaker pays the instrument he is entitled to contribution from other comakers. Grimes v. Grimes, 47 N.C. App. 353, 267 S.E.2d 372 (1980).

A comaker's right to contribution is unaffected by the marital relationship of the parties to a note. Grimes v. Grimes, 47 N.C. App. 353, 267 S.E.2d 372 (1980).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The case cited below was decided under prior statutory revisions.*

Note Without Interest. — A note given for a specified amount "without interest" will be construed to bear interest after maturity. Dowd v. North Carolina R.R., 70 N.C. 468 (1874).

§ 25-3-115. Incomplete instrument.

(a) "Incomplete instrument" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to subsection (c) of this section, if an incomplete instrument is an instrument under G.S. 25-3-104, it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under G.S. 25-3-104, but, after completion, the requirements of G.S. 25-3-104 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under G.S. 25-3-407.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority. (1899, c. 733, ss. 13 to 15; Rev., ss. 2163 to 2165; C.S., ss. 2994 to 2996; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section generally carries forward the rules set out in former Section 3-115. The term "incomplete instrument" applies both to an "instrument," i.e. a writing meeting all the requirements of Section 3-104, and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3-104 and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete solely because a space on the pre-printed note form for the due date is not filled in:

Case #1. If the incomplete instrument is never completed, the note is payable on demand. Section 3-108(a)(ii). However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3-117 if demand for payment is made before the due date agreed to by the parties.

Case #2. If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3-407 governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section 3-109(a)(2). Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3-104. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3-104 and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3-407 applies.

4. Section 3-302(a)(1) also bears on the problem of incomplete instruments. Under that section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) of Section 3-115 is based on the last clause of subsection (2) of former Section 3-115.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

The name of the payee is an essential element. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

Dating is not a necessary element the absence of which makes the instrument incomplete and unenforceable under this section. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

Travelers checks which were not dated and which did not bear the name of the payee remained incomplete and unenforceable as a matter of law, where plaintiff had the authority to complete the instruments, had nine years to do so, and did not. Gray v. American Express Co., 34 N.C. App. 714, 239 S.E.2d 621 (1977).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Scope of Presumptive Authority to Fill Blanks. — The presumptive authority to fill blanks extends to every incomplete feature of the instrument. The authority is to fill all blanks in general conformity to the character of the paper or as the person in possession thinks proper. Jones v. Jones, 268 N.C. 701, 151 S.E.2d 587 (1966), construing former § 25-20 (Section 14, Uniform Negotiable Instruments Law).

Any and all blanks may be filled in which are necessary and proper to make the instrument a perfect and complete bill of exchange or promissory note, as the case may be. Jones v. Jones, 268 N.C. 701, 151 S.E.2d 587 (1966), construing former § 25-20 (Section 14, Uniform Negotiable Instruments Law).

The pronoun "I" or "we" may be inserted under the implied power to fill blanks. Jones v. Jones, 268 N.C. 701, 151 S.E.2d 587 (1966), construing former § 25-20 (Section 14, Uniform Negotiable Instruments Law).

As May Name of Payee. — Parties signing a note with others as makers, the note being complete except for the insertion of the name of the payee or payees, clothe the primary makers with authority to complete the instrument by inserting the name of the payees. Jones v. Jones, 268 N.C. 701, 151 S.E.2d 587 (1966), construing former § 25-20 (Section 14, Uniform Negotiable Instruments Law).

§ 25-3-116. Joint and several liability; contribution.

(a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in G.S. 25-3-419(e) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(c) Discharge of one party having joint and several liability by a person entitled to enforce the instrument does not affect the right under subsection (b) of this section of a party having the same joint and several liability to receive contribution from the party discharged. (1899, c. 733, ss. 17, 68; Rev., ss. 1952, 2217, 2341; C.S., ss. 2998, 3049; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) replaces subsection (e) of former Section 3-118. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section 3-419(e). If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3-419(e) applies. Subsection (c) deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorsers have joint and several liability and subsection (b) applies. The other case is that of two or more anomalous indorsers. The term is defined in Section 3-205(d). An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have joint and several liability and subsection (b) applies.

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Version of Article 3.

I. GENERAL CONSIDERATION.

Cited in Sparks v. Peacock, 129 N.C. App. 640, 500 S.E.2d 116 (1998).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Name Signed at Place Regularly Provided for Makers. — Where the wife of one of the makers of a note affixed her signature and seal to the bottom right-hand corner of the instrument, among the signatures of the makers of the note, although her name was not typed in at the top as a "borrower-debtor," by signing the note at a place regularly provided for makers of a note, she thereby became a maker of the note rather than an indorser. Her signature at this place, plus the fact that the terms of the note itself refer to the "undersigned" as "debtor," dispelled any ambiguity which might have rendered her an indorser under G.S. 25-3-402. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Unambiguous Words Took Precedence Over Miscalculated Figures. — Where plaintiff brought declaratory judgment proceeding to determine amount he owed defendant under two notes he admittedly assumed, words employed obligated makers without qualification to pay defendant two hundred thousand dollars ($200,000) in principal, not some lesser sum, together with eight percent (8%) interest on the unpaid amount, the only conflict in the notes was that final installments stated in schedules were not sufficient to pay "the total amount of principal and interest then due" as text required, court's conclusion that miscalculated figures in installment schedules were overcome by unambiguous words of notes requiring payment of two hundred thousand dollars ($200,000), together with interest, was correct as matter of law. Gray v. Venters, 92 N.C. App. 589, 374 S.E.2d 889 (1989).

Where interest rate on note was usurious and penalty of forfeiture was barred by the statute of limitation, interest allowed was not the maximum legal rate but the legal or judgment rate. Merritt v. Knox, 94 N.C. App. 340, 380 S.E.2d 160 (1989).

§ 25-3-117. Other agreements affecting instrument.

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation. (1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co-maker. Y agrees to sign as co-maker on the condition that Creditor also obtain the signature of Z as co- maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections 3-412 and 3-419(b), Y is obliged to pay the note, but Section 3-117 applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3-117, in treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section 3-106(d), a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due

course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger or integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1-103. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y's obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

CASE NOTES

Editor's Note. — *The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Handwritten agreement between lessees/obligors and representative of lessor/obligee limiting remedies did not qualify as a defense which could be asserted against assignee as a limitation of remedies. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

§ 25-3-118. Statute of limitations.

(a) Except as provided in subsection (e) of this section, an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.

(b) Except as provided in subsection (d) or (e) of this section, if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years.

(c) Except as provided in subsection (d) of this section, an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three years after dishonor of the draft or 10 years after the date of the draft, whichever period expires first.

(d) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within three years after demand for payment is made to the acceptor or issuer, as the case may be.

(e) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the six-year period begins when a demand for payment is in effect and the due date has passed.

(f) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this Article and not governed by this section must be commenced within three years after the cause of action accrues.

(h) A sealed instrument otherwise subject to this Article is governed by the time limits of G.S. 1-47(2). (1995, c. 232, s. 1; 2002-159, s. 7.)

OFFICIAL COMMENT

1. Section 3-118 differs from former Section 3-122, which states when a cause of action accrues on an instrument. Section 3-118 does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section 3-118 is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section 3-118 does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1-103.

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) and (b) apply to notes. If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller's checks, cashier's checks, certified checks, and traveler's checks are treated differently under subsection (d) because they are commonly treated as cash equivalents. A great delay in presenting a cashier's check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler's checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier's check or traveler's check. Under subsection (d) the claim is never barred because the three-year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) covers certificates of deposit. The limitations period of six years doesn't start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) also provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn't start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) states that in that case the six-year limitations period starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six-year limitations period starts to run at the date of the acceptance.

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three-year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

NORTH CAROLINA COMMENT

Subsection (h) has no counterpart in Revised Article 3.

CASE NOTES

When Action Accrues. — The plaintiff's cause of action was not barred by the statute of limitations for contract actions, where the injured party accepted a certain amount from the tortfeasor's insurer for its release of all claims, and its action accrued when it learned that the insurer had stopped payment of a check representing the final installment of the settlement amount when it presented the check to a bank for payment, not 12 days earlier when the bank processed the stop payment order. Rogers Trucking Co. v. North Carolina Farm Bureau Mut. Ins. Co., 130 N.C. App. 130, 501 S.E.2d 112 (1998).

§ 25-3-119. Notice of right to defend action.

In an action for breach of an obligation for which a third person is answerable over pursuant to this Article or Article 4, the defendant may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two litigations, the person notified is so bound unless, after seasonable receipt of the notice, the person notified does come in and defend. (1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section is a restatement of former section 3-803.

Editor's Note. — Article 3 of the Uniform Commercial Code was revised in 1995, and during this revision, former section 25-3-120 became present section 25-4-105.1(a); former section 25-3-121 became present section 25-4-105.1(b); and former section 25-3-122 was omitted. These former sections should no longer appear in Chapter 25.

CASE NOTES

Cited in Kane Plaza Assocs. v. Chadwick, 126 N.C. App. 661, 486 S.E.2d 465 (1997).

PART 2.

NEGOTIATION, TRANSFER, AND INDORSEMENT.

§ 25-3-201. Negotiation.

(a) "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone. ((1899, c. 733, ss. 30-32; Rev., ss. 2178, 2179, 2181; C.S., ss. 3010, 3011, 3013; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsections (a) and (b) are based in part on subsection (1) of former Section 3-202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 to describe this post-issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section 1-201(14) to mean voluntary change of possession. Instead, subsections (a) and (b) use the term "transfer of possession" and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a). If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11). The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 against Seller or a subsequent transferee of the check. Section 3-202(b) provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

3. Other sections of Article 3 may modify the rule stated in the first sentence of subsection (b). See for example, Sections 3-404, 3-405, and 3-406.

Legal Periodicals. — For article, "The Basic Principle of Loss Allocation for Unauthorized Checks," see 39 Wake Forest L. Rev. 453 (2004).

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Who Is Holder of Negotiable Instrument. — Where a negotiable instrument is made payable to order, one becomes a holder of the instrument when it is properly endorsed and delivered to him, and mere possession of a note payable to order does not suffice to prove ownership or holder status. Econo-Travel Motor Hotel Corp. v. Taylor, 301 N.C. 200, 271 S.E.2d 54 (1980).

Right of Payee to Assume That Check Requires His Endorsement. — The payee of a check, as well as the drawer, has a right to expect the drawee bank to pay it in accordance with its terms. Therefore, when the drawer issues a check to the order of a named payee, the payee — absent his agreement to the contrary, or any conduct on his part creating an estoppel — can assume that he has valuable paper of a particular commercial character, i.e., one which will require his endorsement for title to pass to a taker, or for discharge to be effected by the action of the drawee in marking the check "paid" and charging it against the account of the drawer. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37, 147 S.E.2d 386 (1966), decided under NIL.

Since an indorsement by an authorized agent of the "holder" is sufficient to negotiate an instrument, payment or satisfaction to an authorized agent of the "holder" is sufficient to discharge the defendant's liability on the instrument and on the underlying obligation. Summerlin v. National Serv. Indus., Inc., 72 N.C. App. 476, 325 S.E.2d 12 (1985).

An indorsement by an authorized agent of the "holder" is sufficient to validate the transaction. Summerlin v. National Serv. Indus., Inc., 72 N.C. App. 476, 325 S.E.2d 12 (1985).

Applied in First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972); Liles v. Myers, 38 N.C. App. 525, 248 S.E.2d 385 (1978); In re Governor's Island, 39 Bankr. 417 (Bankr. E.D.N.C. 1984).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

What Constitutes Delivery. — To constitute delivery of a negotiable note there must be a parting with the possession and with power and control over it by the maker or indorser for the benefit of the payee or indorsee. To constitute delivery the note must be put out of possession of the indorser. Sinclair v. Travis, 231 N.C. 345, 57 S.E.2d 394 (1950).

A letter written by the payee in transmitting to the maker a note for execution, declaring that the payee had and does will the indebtedness thereby evidenced to his grandchildren, the children of the maker, so that in case of his previous death the notes would be the property of his grandchildren, was insufficient to constitute a gift inter vivos to his grandchildren, there being nothing in the language to show present donative intent, and there being neither actual nor constructive delivery of the notes to them. Sinclair v. Travis, 231 N.C. 345, 57 S.E.2d 394 (1950).

Delivery May Be Actual or Constructive. — Where a negotiable instrument is payable to order, its transfer from one person to another is by indorsement, completed by delivery, actual or constructive. Cartwright v. Coppersmith, 222 N.C. 573, 24 S.E.2d 246 (1943).

When Constructive Delivery is Sufficient. — A constructive delivery will be held sufficient if made with the intention of transferring the title, but there must be some unequivocal act, more than the mere expression of an intention or desire. Cartwright v. Coppersmith, 222 N.C. 573, 24 S.E.2d 246 (1943); Sinclair v. Travis, 231 N.C. 345, 57 S.E.2d 394 (1950).

Delivery to Other Than Payee. — It is not necessary that delivery be made to the payee. If the delivery is made to another, but shows that the maker intended to part with control, and that it was for the payee's benefit, such delivery is sufficient to bind the maker. Irvin v. Harris, 182 N.C. 647, 109 S.E. 867 (1921).

Presumption of Delivery to Holder in Due Course. — Where a negotiable municipal bond was in the hands of a holder in due course, it was conclusively presumed under the NIL that a valid delivery of the bond had been made so far as the rights of the holder were concerned. Bankers' Trust Co. v. City of Statesville, 203 N.C. 399, 166 S.E. 169 (1932).

Presumption of Delivery to Payee. — Whenever a bill or note is found in the hands of the payee it will be presumed that it was delivered to him, but the presumption may be rebutted. Pate v. Brown, 85 N.C. 166 (1881).

Indorsement Must Be Proven Before Presumptions Arise. — Where a note was made payable to X or order, indorsement by him was necessary to transfer the title and give the plaintiffs, as the holder, the benefit of the presumptions of the NIL; and proof of such indorsement by the payee was necessary. Tyson v. Joyner, 139 N.C. 69, 51 S.E. 803 (1905); Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906); Myers v. Petty, 153 N.C. 462, 69 S.E. 417 (1910); First-Citizens Bank & Trust Co. v. Raynor, 243 N.C. 417, 90 S.E.2d 894 (1956).

And Stamp, "Absence of Endorsement Guaranteed," Does Not Change Requirement. — Where a bank accepts a check indorsed only for deposit to the credit of the payee, the bank's stamp "absence of endorsement guaranteed" cannot change the positive law requiring that a negotiable instrument payable to order must be indorsed to constitute the transferee a holder in due course. First-Citizens Bank & Trust Co. v. Raynor, 243 N.C. 417, 90 S.E.2d 894 (1956).

Indorsement with Rubber Stamp is Valid. — Where the name of the drawee is stamped on the back of a draft with a rubber stamp, by one having authority to do so and with intent to indorse it, it is a valid indorsement, but does not prove itself. Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906).

Physical Attachment is Prerequisite to Indorsement on Additional Paper. — While a lack of room for further indorsements is not a prerequisite to attaching a paper, an essential requirement is that the paper be physically attached or that it should have been when the indorsement was made, and an assignment or transfer on a separate paper will not suffice. Midgette v. Basnight, 173 N.C. 18, 91 S.E. 353 (1917); Commercial Sec. Co. v. Main St. Pharmacy, 174 N.C. 655, 94 S.E. 298 (1917).

Partial Assignment Does Not Entitle Assignee to Sue. — An assignment of a note, to enable the assignee to sue thereon, must be made by the payee, and must be for the whole, and not for a part of the sum mentioned in the note. Martin v. Hayes, 44 N.C. 423 (1853).

§ 25-3-202. Negotiation subject to rescission.

(a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(b) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy. (1899, c. 733, ss. 22, 58, 59; Rev., ss. 2180, 2207, 2208; C.S., ss. 3012, 3039, 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section is based on former Section 3-207. Subsection (2) of former Section 3-207 prohibited rescission of a negotiation against holders in due course. Subsection (b) of Section 3-202 extends this protection to payor banks.

2. Subsection (a) applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from that person's possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3-305(c), the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person who pays in good faith and without notice, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3-202 gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

CASE NOTES

Cited in Kane Plaza Assocs. v. Chadwick, 126 N.C. App. 661, 486 S.E.2d 465 (1997).

§ 25-3-203. Transfer of instrument; rights acquired by transfer.

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee. (1899, c. 733, ss. 27, 30-32, 49, 58; Rev., ss. 2175, 2178, 2179, 2181, 2198, 2207; C.S., ss. 3007, 3010, 3011, 3013, 3030, 3039; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-203 is based on former Section 3-201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3-201 did not define "transfer." Subsection (a) defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes issue of an instrument, defined in Section 3-105, and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the instrument "including any right as a holder in due course." If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a person entitled to enforce the instrument under Section 3-301 if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the transferor's rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3-308 that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3-308.

Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b). A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no negotiation of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3-302.

4. The operation of Section 3-203 is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3-305(a)(2).

Case #1. Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X's rights as a holder in due course and takes free of Maker's defense of fraud.

Case #2. Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X's rights as a holder in due course and is subject to Maker's defense of fraud.

Case #3. Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3-301 and succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3-308 Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case #4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of Maker. Purchaser received possession of the note but Payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) restates former Section 3-202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third." Neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less

than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) makes no attempt to state the legal effect of such an assignment, which is left to other law. A partial assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Purpose of former § 25-3-201(1). — The shelter principle of former G.S. 25-3-201(1) seeks to ensure that a holder in due course always enjoys a ready market for the paper he owns. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

The shelter principle of former § 25-3-201(1) applies with greatest vigor to holders of time instruments yet to come due for in such cases the holder cannot collect from the maker. If the holder needs immediate funds, he must turn to the market. If, however, notice of claims and defenses is widespread, free transfer will be inhibited. Thus, this section protects the transferee so as to create a market for the transferor. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

Exclusion from Shelter Principle of Persons Having Notice of Prior Claims. — The exclusion from the shelter principle of one who, having had notice of prior claims, takes back an instrument from a holder in due course rests upon sound principle and simple logic. Operation of the shelter principle in favor of such a person would defeat the purpose of subjecting him to defenses of the maker. Without the exception to the shelter principle, one not a holder in due course, by a transfer and an agreement to repurchase, could readily avoid the limitations under which he held the instrument in the first place. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

The pledgee of a negotiable instrument may qualify as a holder in due course, but the pledgee's rights are limited by his secured creditor's status. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

Claim Falling Outside Protection of Shelter Principle. — Assignee's claim seeking the face value of a certificate of deposit fell outside the protective sweep of the shelter principle in former G.S. 25-3-201(1), where the actual assignor of the instrument, having had notice of prior claims, first assigned the certificate to a third party as security for a loan, then in fact took back the instrument before it was assigned to the assignee, despite efforts to avoid the appearance of reacquisition. Since the actual assignor was not a holder in due course, the assignee could not have become a holder in due course derivatively. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Indorsement is not the only mode by which an interest in notes may be assigned. — Dozier v. Leary, 196 N.C. 12, 144 S.E. 368 (1928), applying this rule in a case where a husband transferred his interest in a note executed by him and his wife by a registered paper writing, which was held competent evidence in an action by the transferee for one-half of the proceeds of the note.

But Subsequent Holder of Order Paper is Not Holder in Due Course Without Indorsement. — Where a note is payable to order and not to bearer, the indorsement of the payee is necessary to transfer the legal title; and where this is not done, a subsequent holder is not one in due course, though the instrument may have been indorsed to him for value by an intermediate holder. Tyson v. Joyner, 139 N.C. 69, 51 S.E. 803 (1905); Steinhilper v. Basnight, 153 N.C. 293, 69 S.E. 220 (1910); Elgin City Banking Co. v. McEachern, 163 N.C. 333, 79 S.E. 680 (1913). See North Carolina Comment to this section. See also Foxman v. Hanes, 218 N.C. 722, 12 S.E.2d 258 (1941).

One making a note payable to her own order and delivering it to another without indorsement does not make the holder a holder in due course. Planters Bank v. Yelverton, 185 N.C. 314, 117 S.E. 299 (1923).

Purchaser as Holder of Equitable Title. — A purchaser of a negotiable instrument for value before maturity, but without indorsement, becomes the holder of the equitable title only, and takes subject to any defense the maker may have against the original payee. Bresee v. Crumpton, 121 N.C. 122, 28 S.E. 351 (1897); Steinhilper v. Basnight, 153 N.C. 293, 69 S.E. 220 (1910); Planters Bank v. Yelverton, 185 N.C. 314, 117 S.E. 299 (1923); Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926); Foxman v. Hanes, 218 N.C. 722, 12 S.E.2d 258 (1941).

The introduction of a note in evidence without indorsement raises the presumption of equitable ownership and assignment, and without proof of indorsement the holder is not one in due course. Woods v. Finley, 153 N.C. 497, 69 S.E. 502 (1910).

Where the plaintiff at the trial presented the draft sued on, with the name of the drawee stamped on the back, and testified that the draft had been discounted to him by the drawee before maturity for value and without notice, he was only the equitable owner, in the absence of proof that the instrument had been indorsed, and he held it subject to any valid defense open to the maker, and it was error to exclude evidence tending to show fraud. Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906).

Indorsement Must Be Obtained before Note is Past Due. — Where a note is assigned as collateral security for another note, and the assignee holds the collateral note without procuring the indorsement of the assignor until after the collateral note is past due, the assignee is not a holder in due course of the collateral note, and takes same subject to all equities existing in favor of the maker of the collateral note as against the payee who assigned same. Hare v. Hare, 208 N.C. 442, 181 S.E. 246 (1935).

Payee Cannot Obtain Bona Fide Holder's Rights in Note Invalid Between Payee and Maker. — If a note is invalid as between the maker and the payee, the payee cannot himself, by purchase from a bona fide holder, become successor to his rights. Ray v. Livingston, 204 N.C. 1, 167 S.E. 496 (1933).

§ 25-3-204. Indorsement.

(a) "Indorsement" means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) "Indorser" means a person who makes an indorsement.

(c) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(d) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection. (1899, c. 733, ss. 17, 27, 30-32, 43, 49, 58, 63; Rev., ss. 1952, 2175, 2178, 2179, 2181, 2192, 2198, 2207, 2212, 2341; C.S., ss. 2998, 3007, 3010, 3011, 3013, 3024, 3030, 3039, 3044; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i). If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3-205(d)) and is made for the purpose of incurring indorser's liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depositary bank for collection and indorses the check by signing the holder's name with the accompanying words "for deposit only" the purpose of the indorse-

ment is both to negotiate the check to the depositary bank and to restrict payment of the check.

The "but" clause of the first sentence of subsection (a) elaborates on former Section 3-402. In some cases it may not be clear whether a signature was meant to be that of an indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as an indorser. Intent may be determined by words accompanying the signature, the place of signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long-established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler's check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer's obligation to pay and its purpose is to provide a means of verifying the identify of the person negotiating the traveler's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser's liability. See Comment 2 to Section 3-106.

The last sentence of subsection (a) is based on subsection (2) of former Section 3-202. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) of Section 3-203 Creditor takes Payee's rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) of Section 3-204 makes clear that Payee's indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) is a restatement of former Section 3-203. Section 3-110(a) states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) allows a person paying or taking the instrument for value or collection to require indorsement in both names.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

***Editor's Note.** — The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Signature Held Not Ambiguous. Where the wife of one of the makers of a note affixed her signature and seal to the bottom right-hand corner of the instrument, among the signatures of the makers of the note, although her name was not typed in at the top as a "borrower-debtor," by signing the note at a place regularly provided for makers of a note, she thereby became a maker of the note rather than an endorser. Her signature at this place, plus the fact that the terms of the note itself refer to the "undersigned" as "debtor," dispelled any ambiguity which might have rendered her an endorser under this section. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Persons Placing Names on Back of Note Are Indorsers. — Persons placing their names on the back of a note are, nothing else appearing, indorsers and are liable on the note only as indorsers. Perry v. Taylor, 148 N.C. 362, 62 S.E. 423 (1908); Houser v. Fayssoux, 168 N.C. 1, 83 S.E. 692 (1914); Fourth Nat'l Bank v. Wilson, 168 N.C. 557, 84 S.E. 866 (1915); Meyers v. Battle, 170 N.C. 168, 86 S.E. 1034 (1915); Barber v. Absher Co., 175 N.C. 602, 96 S.E. 43 (1918); Gillam v. Walker, 189 N.C. 189, 126 S.E. 424 (1925); Dillard v. Farmers Mercantile Co., 190 N.C. 225, 129 S.E. 598 (1925).

Instrument Itself Must Show Other Intention. — "Appropriate words" indicating an intention to be bound other than as an indorser, as provided by the NIL, had to appear upon the instrument itself or in some sufficient writing attached thereto and becoming an essential and integral part thereof, and parol evidence was not admissible to show that one signing as indorser was primarily liable on the note. Waddell v. Hood, 207 N.C. 250, 176 S.E. 558 (1934).

Such as Showing That Indorsers on Back Are Sureties. — When it is set out in the body of a note that indorsers on the back are sureties, they will be held liable as sureties and not as indorsers. Dillard v. Farmers Mercantile Co., 190 N.C. 225, 129 S.E. 598 (1925).

Indorsement by Board of Directors. — Where a resolution by the board of directors of a corporation authorized two of their number, by their signatures, to bind each of the directors individually on any notes due by the company or renewals thereof, the indorsement of such notes by the two directors so authorized bound the other directors as indorsers only and not as principals. Hertford Banking Co. v. Stokes, 224 N.C. 83, 29 S.E.2d 24 (1944).

Parol Evidence Excluded. — Testimony in direct contradiction of the written agreement as expressed in the indorsement to "guarantee payment of this note . . . with full knowledge of this contract" had to be excluded under the NIL. Carr v. Clark, 205 N.C. 265, 171 S.E. 88 (1933).

It is not competent to show that the liability of one whose name is written on the back of a note as an indorser is primary, and not secondary, for the purpose of sustaining the contention that notice of dishonor by nonpayment is dispensed with. Fourth Nat'l Bank v. Wilson, 168 N.C. 557, 84 S.E. 866 (1915); Busbee v. Creech, 192 N.C. 499, 135 S.E. 326 (1926).

Applied in Davis v. Dillard Nat'l Bank, — F. Supp. 2d —, 2003 U.S. Dist. LEXIS 9420 (M.D.N.C. June 4, 2003).

§ 25-3-205. Special indorsement; blank indorsement; anomalous indorsement.

(a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement". When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in G.S. 25-3-110 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement". When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(d) "Anomalous indorsement" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated. (1899, c. 733, ss. 9, 33 to 36, 40; Rev., ss. 2159, 2182 to 2185, 2189; C.S., ss. 2990, 3014 to 3017, 3021; 1949, c. 953; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) is based on subsection (1) of former Section 3-204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3-110 states rules for identifying the payee of an instrument. Section 3-205(a) incorporates the principles stated in Section 3-110 in identifying an indorsee. The language of Section 3-110 refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3-110 must be read as referring to the language used by the indorser.

2. Subsection (b) is based on subsection (2) of former Section 3-204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words 'Pay to the order of' without completing the indorsement by writing the name of the indorsee. The holder's signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3-115.

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection (c) is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section 3-206 can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an "anomalous indorsement," defined in subsection (d), is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3-419.

CASE NOTES

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Blank Indorsement Presumed to Have Been Intended as Transfer. — An indorsement in blank by the payee of a note is presumed to have been intended as a transfer thereof. Davis v. Morgan, 64 N.C. 570 (1870).

And nothing else appearing, such indorsement constitutes a transfer of the note. Coffin v. Smith, 128 N.C. 252, 38 S.E. 864 (1901).

But as between the immediate parties parol evidence is admissible to show a qualified or special contract. Mendenhall v. Davis, 72 N.C. 150 (1875); Hill v. Shields, 81 N.C. 251 (1879); Hoffman v. Moore, 82 N.C. 313 (1880); First Nat'l Bank v. Pegram, 118 N.C. 671, 24 S.E. 487 (1896).

Blank Indorsement Transfers Title to Attorney Holding for Collection. — A bond indorsed in blank and given to an attorney for collection amounts to an assignment of title and conveys authority to the attorney to dispose of it as his own. Parker v. Stallings, 61 N.C. 590 (1868).

Blank Indorsement May Be Made Special. — In case of an indorsement in blank, any holder may fill in the blank over the signature, thus making it payable to himself or some other person. Lilly v. Banker, 88 N.C. 151 (1883).

Where a note is indorsed in blank, the holder has the authority to make it payable to himself or to any other person by filling up the blank over the signature, and this may be done at or before the trial. Johnson v. Hooker, 47 N.C. 29 (1854). It then becomes a special indorsement. Tyson v. Joyner, 139 N.C. 69, 51 S.E. 803 (1905).

But Indorser's Liability Cannot Be Changed. — By filling in over the indorsement, the holder cannot change the indorser's liability. Lilly v. Baker, 88 N.C. 151 (1883).

Indorsement Where Note Payable to Bearer. — Although a note payable to bearer may be transferred by delivery, it may also be transferred by indorsement of the holder, and in such case the indorser incurs the same obligation and liability as an indorser of a note payable to order. Lilly v. Baker, 88 N.C. 151 (1883).

An indorsement in blank of a nonnegotiable instrument does not make it negotiable. Johnson v. Lassiter, 155 N.C. 47, 71 S.E. 23 (1911).

§ 25-3-206. Restrictive indorsement.

(a) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(b) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(c) If an instrument bears an indorsement (i) described in G.S. 25-4-201(b), or (ii) in blank or to a particular bank using the words "for deposit", "for collection", or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(1) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(2) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(3) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(4) Except as otherwise provided in subdivision (3), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(d) Except for an indorsement covered by subsection (c) of this section, if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(1) Unless there is notice of breach of fiduciary duty as provided in G.S. 25-3-307, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(2) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(e) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under subsection (c) of this section or has notice or knowledge of breach of fiduciary duty as stated in subsection (d) of this section.

(f) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section. (1899, c. 733, ss. 36, 37, 39, 47, 137; Rev., ss. 2185, 2186, 2188, 2196, 2287; C.S., ss. 3017, 3018, 3020, 3028, 3119; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section replaces former Sections 3-205 and 3-206 and clarifies the law of restrictive indorsements.

2. Subsection (a) provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation. If a payee indorses "Pay A only," A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses "Pay A if A ships goods complying with our contract," the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3-206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3, Section 3-206(b) rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) and (b) are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) which continues previous law. The depositary bank or the payor bank, if it takes the check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words "For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c), the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) replaces subsection (4) of former Section 3-206. Suppose Payee indorses a check "Pay to T in trust for B." T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3-307 of any breach of fiduciary duty that T may be committing. For example, under subsection (b)* of Section 3-307 these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T's personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

CASE NOTES

Editor's Note. *— The cases cited below were decided under prior statutory law.*

An indorsement to "A.B. for sixty days," if conditional, is only a guaranty for sixty days; if unconditional, it is only to be in force for a limited time. Johnson v. Olive, 60 N.C. 213 (1864), decided under former statutory provisions.

Suit for Collection. — Prior to the passage of the NIL it was uniformly held in this State that a bank holding a note under a restricted indorsement for collection could not bring suit in its own name, but had to bring suit in the name of the indorser. In Third Nat'l Bank v. Exum, 163 N.C. 199, 79 S.E. 498 (1913), decided after the NIL was enacted, the same rule was followed, the court citing prior cases and not referring to the NIL. The case of First Nat'l Bank v. Rochamora, 193 N.C. 1, 136 S.E. 259 (1927), decided the same question and followed the prior ruling. In 5 N.C.L. Rev. 369 (1927) there appears a criticism of these cases. See also Federal Reserve Bank v. Whitford, 207 N.C. 267, 176 S.E. 584 (1934), all cases decided under former statutory provisions.

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*Previous incorrect cross reference corrected by Permanent Editorial Board action November 1992.

§ 25-3-207. Reacquisition.

Reacquisition of an instrument occurs if it is transferred to a former holder by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder. (1889, c. 733, ss. 22, 48, 50, 121; Rev., ss. 2197, 2199, 2271; C.S., ss. 3029, 3031, 3103; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-207 restates former Section 3-208. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3-207 allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

Case #1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X's becoming holder. Section 3-201(a). The instrument by its terms is payable to Y, not to X. But X can obtain the status of holder by striking X's indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending upon how X originally became holder. In either case X becomes holder. Section 1-201(20).

Case #2. X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y's indorsement. The analysis is the same as that in Case #1. X can obtain holder status by canceling X's indorsement to Y.

In Case #1 and Case #2, X acquired ownership of the instrument after reacquisition, but X's title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y's indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3-207 is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3-207 is to nullify it. Thus, the person whose indorsement is canceled is relieved of indorser's liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3-601 and 3-604.

CASE NOTES

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Indorser Reacquiring Instrument — Effect on Subsequent Indorsers. — In 1 N.C.L. Rev. 187 there is a discussion of the NIL which suggests that the rule thereunder was as had been laid down in Adrian v. McCaskill, 103 N.C. 182, 9 S.E. 284 (1989), that one who obtained possession of a negotiable instrument after having formerly indorsed it was restored to his former position and could not hold indorsers subsequent to his first indorsement. The reason for this rule was clearly to avoid circuity of action, for the subsequent indorsers would eventually hold him liable under his first indorsement. To the same effect, see Ray v. Livingston, 204 N.C. 1, 167 S.E. 496 (1933).

Same — Suit Against Prior Indorsers. — An indorser in full, who takes up a bill, is remitted to his former title, and may strike out his indorsement and sue as indorsee those standing before him on the bill, although he may have once made a restrictive indorsement. French v. Barney, 23 N.C. 219 (1840).

Same — Suit Without Striking Subsequent Indorsers. — An indorser of a note may strike out the subsequent indorsers and bring suit, or he may bring suit without striking the subsequent indorsers, as possession is prima facie evidence of payment to the indorsee. Smith v. St. Lawrence, 2 N.C. 230 (1795).

PART 3.

ENFORCEMENT OF INSTRUMENTS.

§ 25-3-301. Person entitled to enforce instrument.

"Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to G.S. 25-3-309 or G.S. 25-3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument. (1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section replaces former Section 3-301 that stated the rights of a holder. The rights stated in former Section 3-301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3. In revised Article 3, Section 3-301 defines "person entitled to enforce" an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3-309. It also includes a person in possession of an instrument who is not a holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a). It also includes any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights.

Legal Periodicals. — For article, "The Basic Principle of Loss Allocation for Unauthorized Checks," see 39 Wake Forest L. Rev. 453 (2004).

CASE NOTES

Editor's Note. — *One of the cases cited below was decided under prior statutory provisions.*

Bank which had cancelled and released a promissory note because of a clerical error, and therefore was not a "holder" in the traditional sense, could still meet burden required by G.S. 25-1-201 by showing that debtor never satisfied the underlying obligation. G.E. Capital Mtg. Servs. v. Neely, 135 N.C. App. 187, 519 S.E.2d 553 (1999).

Other Avenues of Recovery. — Plaintiff bank did not need to rely solely on the law of negotiable instruments to recover debt underlying promissory note which was cancelled because of clerical error; it could also recover under general contract law. G.E. Capital Mtg. Servs. v. Neely, 135 N.C. App. 187, 519 S.E.2d 553 (1999).

Holder May Sue Without Proof of Indorsing Signatures. — Possession of a note raises the presumption that the possessor is a holder thereof, and he may sue thereon without proof of the signatures of the indorsers, since a mere holder of a negotiable instrument may sue thereon in his own name. Dillingham v. Gardner, 219 N.C. 227, 13 S.E.2d 478 (1941), decided under former statutory provisions.

§ 25-3-302. Holder in due course.

(a) Subject to subsection (c) of this section and G.S. 25-3-106(d), "holder in due course" means the holder of an instrument if:

(1) The instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) The holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in G.S. 25-3-306, and (vi) without notice that any party has a defense or claim in recoupment described in G.S. 25-3-305(a).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a) of this section, but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under G.S. 25-3-303(a)(1), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions. (1899, c. 733, ss. 45, 52, 53, 55, 56; Rev., ss. 2194, 2201, 2202, 2204, 2205; C.S., ss. 3026, 3033, 3034, 3036, 3037; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course

doctrine to an instrument that is so incomplete or irregular "as to call into question its authenticity." The term "authenticity" is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3-304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1).

2. Subsection (a)(2) restates subsection (1) of former Section 3-302. Section 3-305(a) makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section 3-305.

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3-305(a)(1), discharge is not expressed in Article 3 as a defense and is not included in Section 3-305(a)(2). Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3-415(d). Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3-601(b). Notice of a defense under Section 3-305(a)(1) of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3-304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: "A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position of the payee as such which made it impossible for him to be a holder in due course." The courts were divided, however, about whether the payee of an instrument could be a holder in due course under the N.I.L.. Some courts read N.I.L. § 52(4) to mean that a person could be a holder in due course only if the instrument was "negotiated" to that person. N.I.L. § 30 stated that "an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof." Normally, an instrument is "issued" to the payee; it is not transferred to the payee. N.I.L. § 191 defined "issue" as the "first delivery of the instrument * * * to a person who takes it as a holder." Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that the payee could be a holder in due course. Professor Britton states on p.318: "The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor * * * against a surety co-maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee."

Former Section 3-302(2) stated: "A payee may be a holder in due course." This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common-law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. § 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3-302(2) has been omitted in revised Article 3 because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3-305) and of claims to the instrument (Section 3-306). The holder-in-due-course doctrine assumes the following case as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor's obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3-303(b). Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection

(a) are met, Holder may enforce the instrument against Obligor free of the defense. Section 3-305(b). In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due course is an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder-in-due-course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case #1. Buyer pays for goods bought from Seller by giving to Seller a cashier's check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the order of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3-103(a)(11). At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3-201. The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case #2 is similar to Case #1. In each case the payee of the instrument has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case #2 that the note does not meet the requirements of Section 3-104(a) and thus is not a negotiable instrument covered by Article 3. In that case, Bank cannot be a holder in due course but the result should be the same. Bank's rights are determined by general principles of contract law. Restatement Second, Contracts § 164(2) governs the case. If Y is induced to enter into a contract with Bank by a fraudulent misrepresentation by X, the contract is voidable by Y unless Bank "in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction." Comment e. to § 164(2) states:

> "This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by a misrepresentation. See Uniform Commercial Code §§ 2-403(1), 3-305. In the cases that fall within [§ 164 (2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

The same result follows in Case #2 if Y had been induced to sign the note as an accommodation party (Section 3-419). If Y signs as co-maker of a note for the benefit of X, Y is a surety with respect to the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3-419(b). If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3-305(b). But the result is the same without resort to holder-in-due-course doctrine. If the note is not a negotiable instrument governed by Article 3, general rules of suretyship apply. Restatement, Security § 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor "without knowledge of the fraud *** extended credit to the principal on the security of the surety's promise ***." The underlying principle of § 119 is the same as that of § 164(2) of Restatement Second, Contracts.

Case #3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of the officer's personal debt, or the check is delivered to Bank for deposit to the officer's personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of Corporation's claim. Section 3-306. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3-307.

Case #4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

5. Subsection (c) is based on former Section 3-302(3). Like former Section 3-302(3), subsection (c) is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights. But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) applies to a sale by a state bank commissioner of the assets of an insolvent bank. However, subsection (c) may be preempted by federal law if the Federal Deposit Insurance Corporation takes over an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsection (d) and (e) clarify two matters not specifically addressed by former Article 3:

Case #5. Payee negotiates a $1,000 note to Holder who agrees to pay $900 for it. After paying $500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) Holder may assert rights as a holder in due course to the extent of $555.55 ($500 ÷ $900 = .555 X $1,000 = $555.55). This formula rewards Holder with a ratable portion of the bargained for profit.

Case #6. Payee negotiates a note of Maker for $1,000 to Holder as security for payment of Payee's debt to Holder of $600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) applies. Holder may assert rights as a holder in due course only to the extent of $600. Payee does not get the benefit of the holder-in-due-course status of Holder. With respect to $400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and the pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) subordinates Article 3 to that law and any other similar law that may evolve in the future. Section 3-106(d) also relates to statutory or administrative law intended to restrict use of the holder-in-due-course doctrine. See Comment 3 to Section 3-106.

Cross References. — For definition of "organization," see G.S. 25-1-201 (28).

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Some Method of Delivery Necessary to Make Obligation Enforceable. — While it is not indispensable that there should have been an actual manual transfer of the instrument from the maker to the payee, yet, to constitute a delivery it must appear that the maker in some way evinced an intention to make it an enforceable obligation against himself, according to its terms, by surrendering control over it and intentionally placing it under the power of the payee or of some third person for his use. Wolfe v. Eaker, 50 N.C. App. 144, 272 S.E.2d 781 (1980), cert. denied, 302 N.C. 222, 277 S.E.2d 69 (1981).

The pledgee of a negotiable instrument may qualify as a holder in due course, but the pledgee's rights are limited by his secured creditor's status. Rozen v. North Carolina Nat'l Bank, 588 F.2d 83 (4th Cir. 1978).

Applied in Lowe's of Sanford, Inc. v. Mid-South Bank & Trust Co., 44 N.C. App. 365, 260 S.E.2d 801 (1979); Alamance Bldrs., Inc. v. Central Carolina Bank & Trust Co., 45 N.C. App. 46, 262 S.E.2d 338 (1980); City Nat'l Bank v. Rojas, 64 N.C. App. 347, 307 S.E.2d 387 (1983).

Cited in Branch Banking & Trust Co. v. Creasy, 44 N.C. App. 289, 260 S.E.2d 782 (1979).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Instrument Must Be Negotiable. — The transfer by indorsement to another of a bond indemnifying a bank from any loss which it might sustain by reason of its taking over the assets and discharging the liabilities of another bank, which bond is not payable to order and hence does not comply with the statutory requirements to be a negotiable instrument, is an assignment of a chose in action, and the assignee is not a holder in due course. North Carolina Bank & Trust Co. v. Williams, 201 N.C. 464, 160 S.E. 484 (1931).

Indorsement is Necessary. — To constitute one a holder in due course it is required that the instrument be indorsed. Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906); Planters Bank & Trust Co. v. Yelverton, 185 N.C. 314, 117 S.E. 299 (1923). See also Keith v. Henderson County, 204 N.C. 21, 167 S.E. 481 (1933).

And Without It Holder Is Subject to Equities. — A holder of a note not indorsed to him is not a holder in due course, and it makes no difference if he had no notice of the equities of the parties, as he is subject to them nevertheless. Steinhilper v. Basnight, 153 N.C. 293, 69 S.E. 220 (1910).

But Enlarged Liability of Indorser Does Not Affect Holder. — A negotiable note indorsed to a holder, bearing an enlarged liability—a guaranty of payment—makes the holder a holder in due course in spite of the enlarged liability of the indorser. Richmond Guano Co. v. Walston, 191 N.C. 797, 133 S.E. 196 (1926).

Indorsement Implies "Due Course" Status. — The holder of a negotiable instrument duly indorsed is, prima facie, a purchaser for value, in good faith, before maturity, and without notice of any defect in the title of the person negotiating it. Smathers v. Toxaway Hotel Co., 168 N.C. 69, 84 S.E. 47 (1915); Worth Co. v. International Feed Co., 172 N.C. 335, 90 S.E. 295 (1916).

The admission by the maker of a promissory note that it had been indorsed to the plaintiff in due course raises the presumption prima facie that he is a holder in due course, and the prima facie case is not rebutted by a denial in the pleadings. Gulf States Steel Co. v. Ford, 173 N.C. 195, 91 S.E. 844 (1917).

Holder for Collection Is Not Holder in Due Course. — A bank taking a note for collection is not a holder in due course. Manufacturers Fin. Co. v. Amazon Cotton Mills Co., 187 N.C. 233, 121 S.E. 439 (1924); Bank v. Rochamora, 193 N.C. 1, 136 S.E. 259 (1927). See §§ 25-4-208, 25-4-209.

Bank Held Not Holder for Collection. — The fact that there is a custom among banks to take drafts for collection and charge them back if they are unpaid is not sufficient evidence to show that a bank holding a draft is not a holder in due course. Elm City Lumber Co. v. Childerhose, 167 N.C. 34, 83 S.E. 22 (1914); nor will the charging back of a check which is unpaid make the holder bank a holder for collection, if the back charge was against an account that consisted of deposited checks that were later returned unpaid. Standard Trust Co. v. Commercial Nat'l Bank, 240 F. 303 (4th Cir. 1917).

Fraud as Preventing Payee from Being Holder in Due Course. — Where the indorser alleged in his answer that he signed note upon representations made by the maker that the payee was lending the money to the maker to finance the equipment of a law office, that in fact the note was given to cover funds of the payee on deposit in a bank which had been wrongfully converted by the maker, and that the payee had full knowledge of, agreed to, and participated in, the fraudulent scheme to procure the indorser to sign the note by such false representations, the answer was sufficiently broad to allege fraud, and the payee was not a holder in due course under this section. Mitchell v. Strickland, 207 N.C. 141, 176 S.E. 468 (1934).

Wrongful Procurement by Agent of Holder. — Defendant's evidence tended to show that he executed the note in suit to be used to pay for shares of stock of the corporate payee, that the stock was never delivered to him and consequently the note was never delivered by him, but that the note was procured from his office without his knowledge or consent by the president of the payee, who was also a collecting agent for a bank, and who turned the note over to the bank as collateral security for his company's note. Held: If in procuring the note the president of the company was acting as an agent of the company, knowledge of the infirmity, nothing else appearing, would not be imputed to the bank and it would be a holder in due course, while if, in procuring the note, he was acting as agent of the bank, the bank would have imputed knowledge of the infirmity and would not be a holder in due course; and therefore, it being admitted that he was an agent of the bank, an instruction that the maker could not be held liable if the note had been taken by an agent of the bank, without further elaboration, was error. National Bank v. Marshburn, 217 N.C. 688, 9 S.E.2d 372 (1940).

Holder of note obtaining same by indorsement after maturity is not a holder in due course. — Mansfield v. Wade, 208 N.C. 790, 182 S.E. 475 (1935).

And Taking Renewal Note Therefor Does Not Cure Defect. — A bank purchasing a note after maturity takes is subject to the equities of the parties. A subsequent note taken as a renewal of the first will not cure the defect and such holder cannot enforce payment. Grace & Co. v. Strickland, 188 N.C. 369, 124 S.E. 856 (1924); Merchants Nat'l Bank v. Howard, 188 N.C. 543, 125 S.E. 126 (1924).

Plaintiff Acquiring Note After Date He Contends It Was Due. — Where plaintiff acquired a note from the payee subsequent to the date plaintiff contended the note was due, plaintiff could not assert that he was a holder in due course before maturity, and he was not protected by the NIL. Industrial Distribs., Inc. v. Mitchell, 255 N.C. 489, 122 S.E.2d 61 (1961).

Question for Jury. — Whether the execution of notes was induced by fraudulent representations held a question for the jury. Clark v. Laurel Park Estates, 196 N.C. 624, 146 S.E. 584 (1929).

§ 25-3-303. Value and consideration.

(a) An instrument is issued or transferred for value if:

(1) The instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(2) The transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) The instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) The instrument is issued or transferred in exchange for a negotiable instrument; or

(5) The instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(b) "Consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due, and the promise has not been performed. If an instrument is issued for value as stated in subsection (a) of this section, the instrument is also issued for consideration. (1899, c. 733, ss. 16, 24, 25 to 27, 28, 54, 58, 59;

Rev., ss. 2166, 2172, 2173 to 2175, 2176, 2203, 2207, 2208; C.S., ss. 2297, 3004, 3005 to 3007, 3008, 3035, 3039, 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) is a restatement of former Section 3-303 and subsection (b) replaces former Section 3-408. The distinction between value and consideration in Article 3 is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) as "any consideration sufficient to support a simple contract." The definition of value in Section 1-201(44), which doesn't apply to Article 3, includes "any consideration sufficient to support a simple contract." Thus, outside Article 3, anything that is consideration is also value. A different rule applies in Article 3. Subsection (b) of Section 3-303 states that if an instrument is issued for value it is also issued for consideration.

Case #1. X owes Y $1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) X's note is issued for value. Under subsection (b) the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case #2. X issues a check to Y in consideration of Y's promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1).

Case #3. X issues a note to Y in consideration of Y's promise to perform services. If at the due date of the note Y's performance is not yet due, Y may enforce the note because it was issued for consideration. But if at the due date of the note, Y's performance is due and has not been performed, X has a defense. Subsection (b).

2. Subsection (a), which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with Buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1). The policy basis for subsection (a)(1) is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument. When Seller took delivery of the check on April 1, Buyer's obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3-310(b). If payment for goods is due at or before delivery and the buyer fails to make the payment, the seller is excused from performing the promise to deliver the goods. Section 2-703. Thus, Seller is protected from an out-of-pocket loss even if the check is not enforceable. Holder-in-due-course status is not necessary to protect Seller.

3. Subsection (a)(2) equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term "security interest" covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4-210. The acquisition of a common-law or statutory banker's lien is also value under subsection (a)(2). An attaching creditor or other person who acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2).

4. Subsection (a)(3) follows former Section 3-303(b) in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Subsection (a)(3) applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) and (5) restate former Section 3-303(c). They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable com-

mitment to a third person, such as a letter of credit issued when an instrument is taken.

CASE NOTES

I. General Consideration.
II. Decisions under Prior Version of Article 3.
III. Decisions under Prior Law.

I. GENERAL CONSIDERATION.

Payment of Antecedent Debt. — Where promissory note was issued as payment of an antecedent claim (old loans) and in exchange for the cancellation of such loans as set forth in subdivisions (a)(1) and (a)(3), the promissory note was supported by consideration as a matter of law. Franklin Credit Recovery Fund v. Huber, 127 N.C. App. 187, 487 S.E.2d 825 (1997), cert. denied, 347 N.C. 398, 494 S.E.2d 411 (1997).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

This section contains no exception as to accommodation makers and there is no basis for inserting one by interpretation. Even though accommodation makers and obligors alike in great numbers sign instruments given in payment of or as security for antecedent obligations of various kinds, this section states without limitation or reservation that consideration is not required for such instruments. Both the intent and effect of this enactment was to deprive all signers of such instruments of the common law defense of no consideration. International Minerals & Chem. Corp. v. Matthews, 71 N.C. App. 209, 321 S.E.2d 545 (1984), cert. denied, 313 N.C. 330, 327 S.E.2d 890 (1985).

The wording of this section contemplates a simultaneous transaction, a commitment to a third person made when the holder takes the instrument, not a commitment made subsequent to the taking of the instrument. Therefore, plaintiff's subsequent reliance on payment of draft did not constitute a taking for value necessary to put plaintiff in the position of holder in due course. Bennett v. United States Fid. & Guar. Co., 19 N.C. App. 66, 198 S.E.2d 33, cert. denied, 284 N.C. 121, 199 S.E.2d 659 (1973).

III. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Amount Paid Is Immaterial. — The title passes to one who takes a negotiable paper without notice of any defect or equities no matter how little he paid, in the absence of fraud. If there is fraud he is only entitled to what he has paid before receiving notice of the fraud. United States Nat'l Bank v. McNair, 116 N.C. 550, 21 S.E. 389 (1895).

The relinquishment of a right of dower was a valid consideration for a promissory note. Trust Co. v. Benbow, 135 N.C. 303, 47 S.E. 435 (1904).

Creditor Taking Instrument for Antecedent Debt Holds for Value. — The transfer of a negotiable note by the holder to his creditor before maturity for an antecedent debt constitutes the transferee a holder for value. American Exch. Nat'l Bank v. Seagroves, 166 N.C. 608, 82 S.E. 947 (1914).

A person who accepts a check for a preexisting debt owed him by the maker is a purchaser for value. National Bank v. Marshburn, 229 N.C. 104, 47 S.E.2d 793 (1948).

Where a bank pledged certain bonds to secure the deposit of a town, the town acquired the bonds for value as security for a pre-existing indebtedness which was sufficient to constitute it a holder in due course within the meaning of the NIL. Standard Inv. Co. v. Town of Snow Hill, 78 F.2d 33 (4th Cir. 1935).

A note given by incorporators of a land company to secure the holder of a mortgage for the purchase price carries sufficient consideration. Johnson v. Rodeger, 119 N.C. 446, 25 S.E. 1021 (1896).

Many of the courts had prior to the NIL denied that an indebtedness was sufficient consideration to constitute one a holder for value within the meaning of the law merchant. The NIL provisions on this question, however, changed the rule. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906).

To the Extent of the Debt Secured. — When a negotiable note is transferred before maturity as collateral security for a pre-existing debt, the assignee is such holder for value that he takes free from equities of which he had no notice, to the extent of the debt secured. See Brooks v. Sullivan, 129 N.C. 190, 39 S.E. 822 (1901). The law was previously otherwise. Harris v. Horner, 21 N.C. 455, 30 Am. Dec. 182 (1836); Holderby v. Blum, 22 N.C. 51 (1838); Potts v. Blackwell, 56 N.C. 449 (1857), appeal dismissed, 57 N.C. 58 (1858).

An interpleader, where a note has been attached, who claims as a holder in due course, and makes it appear that the note was taken as collateral security to another note, is a holder in due course only to the extent of his lien. The balance is subject to attachment. Sugg v. St. Mary's Oil Engine Co., 193 N.C. 814, 138 S.E. 169 (1927).

A bank taking a warehouse receipt as collateral security is a holder in due course to the extent of its lien. Lacy v. Globe Indem. Co., 189 N.C. 24, 126 S.E. 316 (1925).

Unless Note Was Nonnegotiable. — The provision of the NIL that a pre-existing debt is sufficient consideration for a promissory note did not apply when the note in question was not negotiable within the meaning of the NIL, and the debt was not contracted by the maker; and where a nonnegotiable note was given by a widow for the defalcation of her husband without consideration, it had to be alleged and shown that she knowingly accepted profit, advantage or benefit from the transaction. Peoples Bldg. & Loan Ass'n v. Swaim, 198 N.C. 14, 150 S.E. 668 (1929).

Restriction on Right of Recovery. — Where the original consideration of the paper is illegal or fraudulent, or it is taken as collateral security, the right of recovery is restricted to the consideration actually paid by the indorsee before notice of the fraud. Dresser v. Missouri & I. Ry. Constr. Co., 93 U.S. 92, 23 L. Ed. 815 (1876), or the amount of the debt to which it is collateral. Kerr v. Cowen, 17 N.C. 356 (1833); O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Want of Consideration Is Defense Against Payee. — A total absence of consideration is a matter of defense by the maker against the original payee. Swift & Co. v. Aydlett, 192 N.C. 330, 135 S.E. 141 (1926).

A note given for the purchase price of fertilizer, reciting that there is not warranty, is subject to the defense of lack of consideration, and if it appears that the fertilizer was not the grade as shown by the analysis on the sack, the plaintiff is not entitled to recover on the note. Swift v. Etheridge, 190 N.C. 162, 129 S.E. 453 (1925).

Negotiable Instrument Is Not Deemed Issued as Gift. — A negotiable instrument is deemed prima facie to have been issued for a valuable consideration and not as a gift, unless the circumstances indicate otherwise. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

A note under seal creates a rebuttable presumption of consideration. Wachovia Bank & Trust Co. v. Smith Crossroads, Inc., 258 N.C. 696, 129 S.E.2d 116 (1963).

But failure of consideration is a valid defense to a note under seal by reason of the fact the presumption arising from a seal upon a negotiable instrument is rebuttable. Patterson v. Fuller, 203 N.C. 788, 167 S.E. 74 (1933).

As Against Anyone Other Than Holder in Due Course. — It is the general rule in this jurisdiction and elsewhere that a total failure of the consideration for a note under seal renders it unenforceable in the hands of any person other than a holder in due course. Mills v. Bonin, 239 N.C. 498, 80 S.E.2d 365 (1954).

Since Presumption of Consideration May Be Rebutted. — While the execution and delivery of a note under seal raises the presumption of consideration, such presumption, under the NIL, was rebuttable as against any person not a holder in due course. Lentz v. Johnson & Sons, 207 N.C. 614, 178 S.E. 226 (1935); Mills v. Bonin, 239 N.C. 498, 80 S.E.2d 365 (1954).

But the lack of consideration cannot benefit the maker of a bond under seal, because the law conclusively presumes that it was made upon good and sufficient consideration. Angier v. Howard, 94 N.C. 27 (1886); Wester v. Bailey, 118 N.C. 193, 24 S.E. 9 (1896).

Under the NIL one taking without indorsement takes subject to equities between the original parties, and the presumption of consideration may be rebutted. Planter's Bank v. Yelverton, 185 N.C. 314, 117 S.E. 299 (1923).

Failure of Consideration May Be Shown. — A contract for carrying mail is not assignable, and in an action on a note given in part consideration of such assignment this may be shown as a failure of consideration, except as against a holder for value, in due course, without notice. Peoples Bank & Trust Co. v. Duncan, 194 N.C. 692, 140 S.E. 610 (1927).

Without Violating Parol Evidence Rule. — The rule which prohibits the introduction of parol evidence to vary, modify or contradict the terms of a written instrument is not violated by showing failure of consideration. Virginia Trust Co. v. City of Asheville, 207 N.C. 162, 176 S.E. 257 (1934).

Failure of consideration is an affirmative defense and therefore must be specifically pleaded by setting out the applicable facts. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

Failure of consideration may not be shown under a general denial of indebtedness. Diemar & Kirk Co. v. Smart Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1964).

Burden of Proof. — When plaintiff declared on a past-due negotiable note regular in form, and offered evidence of its execution by defendants, a prima facie case was made out, which imposed upon defendant the burden of going forward with evidence to rebut the presumption created by the NIL or incur the risk of an adverse verdict. Beam v. Wright, 224 N.C. 677, 32 S.E.2d 213 (1944).

Where, between the original parties, the maker sets up the want of consideration for a note he has made to the payee as a defense, in an action thereon the burden is upon him to introduce evidence to establish his defense, and his failure to do so will entitle the payee to a judgment in his favor. Merchants Nat'l Bank v. Andrews, 179 N.C. 341, 102 S.E. 500 (1920).

Where there was evidence tending to show that the president of a bank had received from the defendant an exchange of notes for the former's benefit, and that the defendant in the bank's action on the note admitted its execution and delivery, this was prima facie evidence that the note was given for a consideration, and a defendant must show failure of consideration when relied upon by him. American Trust Co. v. Anagnos, 196 N.C. 327, 145 S.E. 619 (1928).

While a valuable consideration is essential to the support of negotiable instruments, it is not necessary in an action upon them for the plaintiff to aver and prove such consideration; yet when evidence has been introduced by the defendant to rebut the presumption which they raise, the burden is thrown upon the plaintiff to satisfy the jury by a preponderance of evidence that there was a consideration. Campbell v. McCormac, 90 N.C. 491 (1884); Hunt v. Eure, 188 N.C. 716, 125 S.E. 484 (1924).

§ 25-3-304. Overdue instrument.

(a) An instrument payable on demand becomes overdue at the earliest of the following times:

(1) On the day after the day demand for payment is duly made;

(2) If the instrument is a check, 90 days after its date; or

(3) If the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(b) With respect to an instrument payable at a definite time the following rules apply:

(1) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(2) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(3) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(c) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal. (1899, c. 733, ss. 45, 52, 53, 55, 56; Rev., ss. 2194, 2201, 2202, 2204, 2205; C.S., ss. 3026, 3033, 3034, 3036, 3037; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3-302(a)(2)(iii). Section 3-304 replaces subsection (3) of former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3-304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken "more than a reasonable length of time after its issue." In substitution for this test, subsection (a)(3) requires the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending on the facts of the particular case.

2. Subsections (b) and (c) cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

CASE NOTES

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Irregularities on Face of Instrument Do Not Charge Holder with Notice. — Under the NIL, observable irregularities on the face of the instrument did not suffice to affect the rights of a holder in due course. It was necessary that circumstances set out in the NIL should occur in order to charge the holder with notice. Smathers & Co. v. Toxaway Hotel Co., 162 N.C. 346, 78 S.E. 224 (1913); Smathers & Co. v. Toxaway Hotel Co., 167 N.C. 469, 83 S.E. 844 (1914); Critcher v. Ballard, 180 N.C. 111, 104 S.E. 134 (1920); Holleman v. Harnett County Trust Co., 185 N.C. 49, 115 S.E. 825 (1923); Lacy v. Globe Indem. Co., 189 N.C. 24, 126 S.E. 316 (1925). And see Piedmont Carolina Ry. v. Shaw, 223 F. 973 (4th Cir. 1915).

Nor Do Facts That Note Is Discounted by Stranger and That Alternative Place of Payment Is Unknown. — The fact that a note is negotiated by a stranger at a discount and that one of the alternative places of payment was not known to the holder are not sufficient to put him on notice of the defects. Farthing v. Dark, 111 N.C. 243, 16 S.E. 337 (1892). This case was reported in Farthing v. Dark, 109 N.C. 291, 13 S.E. 918 (1891), but at that time the court was not advertent to the fact that there was an alternative place of payment.

But Indorsee with Actual Notice of Fraud Is Subject to Equities. — When a note is signed through fraud of another and is discounted with an indorsee that had notice of this fraud, the indorsee is subject to the equities between the parties. Grace & Co. v. Strickland, 188 N.C. 369, 124 S.E. 856 (1924).

And Facts Known May Give Rise to Duty to Inquire. — When a person has knowledge of such facts and circumstances as make it incumbent on him to inquire as to the character of the note which he purchased, he will be affected with knowledge of all that the inquiry would disclose. Bunting v. Ricks, 22 N.C. 130, 32 Am. Dec. 699 (1838); Hulbert v. Douglas, 94 N.C. 122 (1886); Loftin v. Hill, 131 N.C. 105, 42 S.E. 548 (1902).

Mere Knowledge of Assignor's Crookedness Is Insufficient. — Knowledge of assignor's crookedness in business matters does not defeat the title of the assignee or make it his duty to inquire relative to the note. Setzer v. Deal, 135 N.C. 428, 47 S.E. 466 (1904).

And fact that interest is past due does not of itself constitute notice of equities between the parties, although it may be considered by the jury in passing on the issue. Fidelity Trust Co. v. Whitehead, 165 N.C. 74, 80 S.E. 1065 (1914).

Nor Does Statement of Transaction on Face of Note. — A note containing on its face an express statement of the transaction for which it was given, in the absence of further evidence, is not notice of the equities between the parties. Bank of Sampson v. Hatcher, 151 N.C. 359, 66 S.E. 308 (1909).

Notice to Bank Through Officers. — A note payable to an officer of a bank and discounted at the bank through the discount committee does not make the bank subject to the principle of imputed knowledge when the officer is not a member of the discount committee. Merchants Nat'l Bank v. Howard, 188 N.C. 543, 125 S.E. 126 (1924).

A bank taking a note indorsed to it by its president takes with notice of all equities between the parties, when the president and cashier constitute the discount committee, as notice to the president constitutes notice to the bank. Le Duc v. Moore, 111 N.C. 516, 15 S.E. 888 (1892), cert. denied, 113 N.C. 275, 18 S.E. 70 (1893).

Blank Indorsement Presumed Made When Instrument Executed. — Indorsements in blank upon negotiable instruments are presumed to be made contemporaneously with the execution of such instruments. Southerland v. Freemont, 107 N.C. 565, 12 S.E. 237 (1890).

And Note with Undated Indorsement to Person Now Deceased Presumed Acquired in Due Course. — Where a negotiable instrument has been indorsed to a decedent, and it is found among his papers, the indorsement not bearing a date, he is prima facie presumed to have acquired it in due course. Price Real Estate & Ins. Co. v. Jones, 191 N.C. 176, 131 S.E. 587 (1926).

Holder of Cashier's Check Negotiated Within Reasonable Time Holds in Due Course. — Cashier's checks, whether certified or otherwise, are classed with bills of exchange payable on demand; and if negotiated by indorsement for value without notice and within a reasonable time, a holder can maintain the position of a holder in due course. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906).

Five Days as Reasonable Time for Negotiating Cashier's Check. — A cashier's check negotiated to a holder in another state within five days is negotiated in a reasonable time. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906).

Notice to Holder Held Question for Jury. — Where there is conflicting evidence as to notice the holder had of equities between the parties, the issue should be submitted to a jury. Loftin v. Hill, 131 N.C. 105, 42 S.E. 548 (1902).

Failure to Instruct on Notice Held Error. — Where there is evidence that the holder of a negotiable instrument had notice of its infirmity, the question is for the jury, and a failure to instruct thereon is reversible error. People's Bank & Trust Co. v. Duncan, 194 N.C. 692, 140 S.E. 610 (1927).

§ 25-3-305. Defenses and claims in recoupment.

(a) Except as stated in subsection (b) of this section, the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) A defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) A defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) A claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1) of this section, but is not subject to defenses of the obligor stated in subsection (a)(2) of this section or claims in recoupment stated in subsection (a)(3) of this section against a person other than the holder.

(c) Except as stated in subsection (d) of this section, in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (G.S. 25-3-306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) of this section that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity. (1899, c. 733, s. 15, 16, 28, 57, 58, 59; Rev., ss. 2165, 2166, 2176, 2206, 2207, 2208; C.S., ss. 2297, 2996, 2997, 3008, 3038, 3039, 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b).

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)); failure to countersign a traveler's check (Section 3-106(c)); modification of the obligation by a separate agreement (Section 3-117); payment that violates a restrictive indorsement (Section 3-206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)), and breach of warranty when a draft is accepted (Section 3-417(b)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302.

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank's defense of fraud. This case is discussed as Case #1 in Comment 4 to Section 3-302. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3-305. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b). This defense is included in Section 3-305(a)(2). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b). Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment *** against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv)) and Buyer may assert the claim against Holder (Section 3-305(a)(3)) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b).

The result under Section 3-305 is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section 3-305(a)(3) is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3). Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) and Comment 3 to Section 3-106. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3-306 based on a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) and Comment 2 to Section 3-201. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3-419) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in recoupment is good against the indorser. Section 3-416(a)(4). Thus, if the indorsee sues the indorser because of dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

Legal Periodicals. — For article, "The Contracts of Minors Viewed from the Perspective of Fair Exchange," see 50 N.C.L. Rev. 517 (1972).

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

In a negotiable instrument case where no holder in due course rights are involved, the available defenses include all defenses of any party which would be available on a simple contract. In re Governor's Island, 39 Bankr. 417 (Bankr. E.D.N.C. 1984).

Section 25-9-318 adopts the better common-law view as to when defenses are available on a simple contract and was to be followed in interpreting former G.S. 25-3-306(b). Further, no difference in result should obtain between the common law and the UCC result for assignments of contract rights and assignments of instruments to persons not holders in due course. In all cases, the rules of G.S. 25-9-318 ought to control what defenses against the assignor can be asserted against the assignee. In re Governor's Island, 39 Bankr. 417 (Bankr. E.D.N.C. 1984).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Under NIL Only Defective Title Prevented Enforcement of Note by Holder in Due Course. — One taking a note as a holder in due course could, under the NIL, enforce his right against all prior parties, except in case of a defective title. Davidson v. Powell, 114 N.C. 575, 19 S.E. 601 (1894); United States Nat'l Bank v. McNair, 116 N.C. 550, 21 S.E. 389 (1895); First Nat'l Bank v. Griffin, 153 N.C. 72, 68 S.E. 919 (1910); Standing Stone Nat'l Bank v. Walser, 162 N.C. 53, 77 S.E. 1006 (1913).

But Maker Could Set Up Defenses against Holder Not in Due Course. — The maker of a note could not set up defenses he might have against the payee of the note in an action by a holder in due course, but where the holder was not a holder in due course without notice, the maker could set up all defenses which he might have as against the payee. Federal Reserve Bank v. Atmore, 200 N.C. 437, 157 S.E. 129 (1941).

Under the NIL, where the answer sufficiently alleged that the holder was not a holder in due course for value without notice, all defenses which the defendant might have were presentable under the pleadings. Federal Reserve Bank v. Atmore, 200 N.C. 437, 157 S.E. 129 (1941).

Generally, Bona Fide Holder's Title Was Valid Against Everyone. — Subject to certain limitations, e.g., when a negotiable instrument is declared void by statue, legal incapacity to contract, or fraud in the factum, the rule under the law merchant and also under the NIL was that a bona fide holder of a negotiable instrument in due course held a title valid as against all the world. State Planters Bank v. Courtesy Motors, Inc., 250 N.C. 466, 109 S.E.2d 189 (1959).

Rights of Holders of Notes Tainted with Usury or Illegality. — When by statute the paper is void in whole or in part from its inception, as for usury or for gaming or immoral contracts, it is void to the same extent into whosoever hands it may pass, even if acquired before maturity, for value and without notice, and the sole remedy of the holder for the deficiency is against the indorser. Ward v. Sugg, 113 N.C. 489, 18 S.E. 717 (1893); United States Nat'l Bank v. McNair, 116 N.C. 550, 21 S.E. 389 (1895).

Where the original consideration of the paper is illegal or fraudulent, or it is taken as collateral security, the right of recovery is restricted to the consideration actually paid by the indorsee before notice of the fraud, or the amount of the debt to which it is collateral. But the exception does not extend further, not even to cases where the note was issued without any consideration, though it may be purchased by the indorsee for less than its face value. United States Nat'l Bank v. McNair, 116 N.C. 550, 21 S.E. 389 (1895).

When a note, on which the payee has charged or received usury, and which is negotiable in form, has been indorsed and delivered by the payee, before maturity, for value, and without notice of any defect in the title of the payee, or of any equity which the maker is entitled to enforce against the payee, to a third person, who thereby becomes a holder in due course of the note, such holder in an action on the note may recover of the maker the principal of the note, but cannot recover interest thereon, for the reason that the law declares the promise to pay interest, in such case, void. Federal Reserve Bank v. Jones, 205 N.C. 648, 172 S.E. 185 (1934).

Where a borrower is entitled to enforce an equity against the payee because of a device to evade the usury laws, namely, the withholding of a part of the face amount of the note, this equity cannot be enforced against a holder in due course. Federal Reserve Bank v. Jones, 205 N.C. 648, 172 S.E. 185 (1934), affirming judgment for face amount of note, less credit for a payment, with interest from date of judgment.

Presumption of Sanity of Maker. — There is a rebuttable presumption that a promisor was sane at the time of the execution of a note, and on that question the burden of showing the contrary, as a general rule, is upon the defendant or the person alleging it. Jones v. Winstead, 186 N.C. 536, 120 S.E. 89 (1923).

Collateral Agreements. — Under the NIL it was competent to prove a collateral agreement, as between the immediate parties, making a note nonpayable upon a contingency which would deprive the note of all consideration, even though the note was under seal. Farrington v. McNeill, 174 N.C. 420, 93 S.E. 957 (1917).

In an action upon a note the defendants were not permitted to set up the defense that as a part of the contemporaneous parol agreement they were given further time, until certain lands had been sold, for such would be in contradiction of the written instrument. Cherokee County v. Meroney, 173 N.C. 653, 92 S.E. 616 (1917).

§ 25-3-306. Claims to an instrument.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument. (1899, c. 733, ss. 15, 16, 28, 57, 58, 59; Rev., ss. 2165, 2166, 2176, 2206, 2207, 2208; C.S., ss. 2297, 2996, 2997, 3008, 3038, 3039, 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section expands on the reference to "claims to" the instrument mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3-202(b) for rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3-306 are different from claims in recoupment referred to in Section 3-305(a)(3).

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

One who acquires a note as a mere assignee, without the paying of consideration therefor, is not a holder in due course. Ridley v. Jim Walter Corp., 272 N.C. 673, 158 S.E.2d 869 (1968).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Instrument Is Subject to Defenses If Due Course Is Not Proved. — If plaintiff fails to prove that he was a holder in due course, the notes, although in his hands as a holder, other than a holder in due course, are subject to the same defenses as if they were nonnegotiable. Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926).

Thus, past-due instrument, lodged with bank as security, is subject to all defenses. Battery Park Bank v. Loughran, 126 N.C. 814, 36 S.E. 281 (1900).

As Is Unindorsed Instrument Not Payable to Bearer. — The transferee of an unindorsed instrument not payable to bearer also takes subject to defenses. Bresee v. Crumpton, 121 N.C. 122, 28 S.E. 351 (1897).

Maker May Prove Payment Where Holder Took After Maturity. — Where the holder of a negotiable note obtains same by indorsement after maturity, he takes same subject to equities, and the maker of the note may establish as against such holder that the note was paid before it was indorsed to and acquired by the holder. Mansfield v. Wade, 208 N.C. 790, 182 S.E. 475 (1935).

But Purchaser After Maturity Takes Free of Agreement of Third Person to Pay Note. — A purchaser for value after maturity takes the note free from an agreement by a third person to pay the note when such third person was never a purchaser or holder of the note and the purchaser has no knowledge of such agreement between the maker and the third person. Pickett v. Fulford, 211 N.C. 160, 189 S.E. 488 (1937).

§ 25-3-307. Notice of breach of fiduciary duty.

(a) In this section:

(1) "Fiduciary" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument.

(2) "Represented person" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in subdivision (1) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty or knows such facts that his action in taking the instrument is not in good faith.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person. (1899, c. 733, s. 45, 52, 53, 55, 56; Rev., ss. 2194, 2201, 2202, 2204, 2205; C.S., ss. 3026, 3033, 3034, 3036, 3037; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section states rules for determining when a person who has taken an instrument from a fiduciary has notice of a breach of fiduciary duty that occurs as a result of the transaction with the fiduciary. Former Section 3-304(2) and (4)(e) related to this issue, but those provisions were unclear in their meaning. Section 3-307 is intended to clarify the law by stating rules that comprehensively cover the issue of when the taker of an instrument has notice of breach of a fiduciary duty and thus notice of a claim to the instrument or its proceeds.

2. Subsection (a) defines the terms "fiduciary" and "represented person" and the introductory paragraph of subsection (b) describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) states that notice of breach of fiduciary duty is notice of the represented person's claim to the instrument or its proceeds.

Under Section 3-306, a person taking an instrument is subject to a claim to the instrument or its proceeds, unless the taker has rights of a holder in due course. Under Section 3-302(a)(2)(v), the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3-306. Section 3-307 applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3-306. Section 3-307 states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

Section 3-307(b) applies only if the person dealing with the fiduciary "has knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge is not enough to cause Section 3-307 to apply. "Knowledge" is defined in Section 1-201(25). In most cases, the "taker" referred to in Section 3-307 will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section 1-201(27). In many cases, the individual who receives and processes an instrument on behalf of the organization that is the taker of the instrument "for payment or collection or for value" is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section 3-307 doesn't apply because, under Section 1-201(27), knowledge of the organization is determined by the knowledge of the "individual conducting that transaction," i.e. the clerk who receives and processes the instrument. Furthermore, paragraphs (2) and (4) each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the represented person or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the fiduciary or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section 3-307 to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

3. Subsection (b)(2) applies to instruments payable to the represented person or the fiduciary as such. For example, a check payable to Corporation is indorsed in the name of Corporation by Doe as its President. Doe gives the check to Bank as partial repayment of a personal loan that Bank had made to Doe. The check was indorsed either in blank or to Bank. Bank collects the check and applies the proceeds to reduce the amount owed on Doe's loan. If the person acting for Bank in the transaction knows that Doe is a fiduciary and that the check is being used to pay a personal obligation of Doe, subsection (b)(2) applies. If Corporation has a claim to the proceeds of the check because the use of the check by Doe was a breach of fiduciary duty, Bank has notice of the claim and did not take the check as a holder in due course. The same result follows if Doe had indorsed the check to himself before giving it to Bank. Subsection (b)(2) follows Uniform Fiduciaries Act G.S. 4 in providing that if the instrument is payable to the fiduciary, as such, or to the represented person, the taker has notice of a claim if the instrument is negotiated for the fiduciary's personal debt. If fiduciary funds are deposited to a personal account of the fiduciary or to an account that is not an account of the represented person or of the fiduciary, as such, there is a split of authority concerning whether the bank is on notice of a breach of fiduciary duty. Subsection (b)(2)(iii) states that the bank is given notice of breach of fiduciary duty because of the deposit. The Uniform Fiduciaries Act G.S. 9 states that the bank is not on notice unless it has knowledge of facts that makes its receipt of the deposit an act of bad faith.

The rationale of subsection (b)(2) is that it is not normal for an instrument payable to the represented person or the fiduciary, as such, to be used for the personal benefit of the fiduciary. It is likely that such use reflects an unlawful use of the proceeds of the instrument. If the fiduciary is entitled to compensation from the represented person for services rendered or for expenses incurred by the fiduciary the normal mode of payment is by a check drawn on the fiduciary account to the order of the fiduciary.

4. Subsection (b)(3) is based on Uniform Fiduciaries Act G.S. 6 and applies when the instrument is drawn by the represented person or the fiduciary as such to the fiduciary personally. The term "personally" is used as it is used in the Uniform Fiduciaries Act to mean that the instrument is payable to the payee as an individual and not as a fiduciary. For example, Doe as President of Corporation writes a check on Corporation's account to the order of Doe personally. The check is then indorsed over to Bank as in Comment 3. In this case there is no notice of breach of fiduciary duty because there is nothing unusual about the transaction. Corporation may have owed Doe money for salary, reimbursement for expenses incurred for the benefit of Corporation, or for any other reason. If Doe is authorized to write checks on behalf of Corporation to pay debts of Corporation, the check is a normal way of paying a debt owed to

Doe. Bank may assume that Doe may use the instrument for his personal benefit.

5. Subsection (b)(4) can be illustrated by a hypothetical case. Corporation draws a check payable to an organization. X, an officer or employee of Corporation, delivers the check to a person acting for the organization. The person signing the check on behalf of Corporation is X or another person. If the person acting for the organization in the transaction knows that X is a fiduciary, the organization is on notice of a claim by Corporation if it takes the instrument under the same circumstances stated in subsection (b)(2). If the organization is a bank and the check is taken in repayment of a personal loan of the bank to X, the case is like the case discussed in Comment 3. It is unusual for Corporation, the represented person, to pay a personal debt of Doe by issuing a check to the bank. It is more likely that the use of the check by Doe reflects an unlawful use of the proceeds of the check. The same analysis applies if the check is made payable to an organization in payment of goods or services. If the person acting for the organization knew of the fiduciary status of X and that the goods or services were for X's personal benefit, the organization is on notice of a claim by Corporation to the proceeds of the check. See the discussion in the last paragraph of Comment 2.

NORTH CAROLINA COMMENT

Subdivision (b)(3) is modified to conform to the Uniform Fiduciaries Act (G.S. 32-1 through 32-13) by inserting the phrase "or knows such facts that his action in taking the instrument is not in good faith."

Legal Periodicals. — For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

§ 25-3-308. Proof of signatures and status as holder in due course.

(a) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under G.S. 25-3-402(a).

(b) If the validity of signatures is admitted or proved and there is compliance with subsection (a) of this section, a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under G.S. 25-3-301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim. (1899, c. 733, s. 59; Rev., s. 2208; C.S., s. 3040; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-308 is a modification of former Section 3-307. The first two sentences of subsection (a) are a restatement of former Section 3-307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant's claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an oppor-

tunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section 1-201. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). "Presumed" is defined in Section 1-201 and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section 1-201 and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) is a new provision that is necessary to take into account Section 3-402(a) that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) restates former Section 3-307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves "entitlement to enforce the instrument" because under Section 3-301 a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3-301. That person must prove a transfer giving that person such rights under Section 3-203(b) or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under Section 3-203(b) or by subrogation or succession. All elements of Section 3-302(a) must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Words Purporting to Be Indorsement Do Not Prove Themselves. — Words, written on the back of a negotiable instrument, purporting to be an indorsement by which the instrument was negotiated, do not prove themselves. Bank of Statesville v. Blackwelder Furn. Co., 11 N.C. App. 530, 181 S.E.2d 785, cert. denied, 279 N.C. 393, 183 S.E.2d 241 (1971).

The mere introduction of a note, payable to order, with words written on the back thereof, purporting to be an indorsement by the payee, does not prove or tend to prove their genuineness. Bank of Statesville v. Blackwelder Furn. Co., 11 N.C. App. 530, 181 S.E.2d 785, cert. denied, 279 N.C. 393, 183 S.E.2d 241 (1971).

Burden of Proving Due Course Status. — Where an infirmity in the note has been established so as to create a valid defense by the maker and this defense is sought to be avoided by the establishment of a holder in due course, then the person claiming to be the holder in due course has the burden of proving it. Bank of Statesville v. Blackwelder Furn. Co., 11 N.C. App. 530, 181 S.E.2d 785, cert. denied, 279 N.C. 393, 183 S.E.2d 241 (1971).

For a person to acquire the position of a holder in due course of a negotiable instrument so as to effectually cut off any defenses which the maker might have, he has the burden of establishing that he is, in all respects, a holder in due course. This includes establishing the authority of a purported endorser to execute such indorsement. Bank of Statesville v. Blackwelder Furn. Co., 11 N.C. App. 530, 181 S.E.2d 785, cert. denied, 279 N.C. 393, 183 S.E.2d 241 (1971).

Burden Not Carried by Presenting Only Note to Prove Authority of Endorser. — Where defendant had established, by admissions and affidavits, that it had a defense of failure of consideration insofar as the payee was concerned, and the plaintiff sought to cut off this defense by being a holder in due course, the burden thereupon fell to the plaintiff to show that it was "in all respects a holder in due course." By presenting nothing more than the note itself to prove the authority of the endorser to endorse for the payee, plaintiff failed to carry his burden. Bank of Statesville v. Blackwelder Furn. Co., 11 N.C. App. 530, 181 S.E.2d 785, cert. denied, 279 N.C. 393, 183 S.E.2d 241 (1971).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Maker Must Show Lack of Consideration. — Where, between the original parties, the maker sets up want of consideration for a note he has made to the payee, as a defense in an action thereon, the burden is upon him to introduce evidence to establish his defense, and his failure to do so will entitle the payee to a judgment in his favor. Piner v. Brittain, 165 N.C. 401, 81 S.E. 462 (1914); Merchants Nat'l Bank v. Andrews, 179 N.C. 341, 102 S.E. 500 (1920).

Presumption of Due Course Existed Where Bill of Lading Was Attached. — Under the NIL the presumption that the holder was one in due course existed in favor of the holder of a draft payable to order with bill of lading attached. Willard Mfg. Co. v. Tierney, 133 N.C. 630, 45 S.E. 1026 (1903); Magnum v. Mutual Grain Co., 184 N.C. 181, 114 S.E. 2 (1922).

And Where Duly Negotiated Note Was Found Among Decedent's Papers. — When a properly negotiated note is found among the papers of a deceased person, that is prima facie evidence that the holder is a holder in due course, and until it is alleged and shown by a party liable on the note that it is defective, the evidence is sufficient for the administrator of the holder to recover thereon. Price Real Estate & Ins. Co. v. Jones, 191 N.C. 176, 131 S.E. 587 (1926).

This presumption did not exist in favor of the holder of an unindorsed note not payable to bearer. Tyson v. Joyner, 139 N.C. 69, 51 S.E. 803 (1905).

Presumption Operated Where Defective Title Was Not Alleged or Proved. — Under the NIL the presumption that the holder was one in due course became operative as a matter of course where there was neither allegation nor proof that the title to a negotiable instrument was defective. The holder by indorsement was only required to prove that the indorsement in order for him to be deemed prima facie a holder in due course. Moon v. Simpson, 170 N.C. 335, 87 S.E. 118 (1915).

But Proof of Defective Title Put Burden on Holder to Show Due Course. — Under the NIL, when it was shown or admitted that the title of the person who negotiated the instrument was defective, or there was evidence of the fact, it was necessary for one claiming to be the holder in due course to show by the greater weight of the evidence that he was such a holder. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906); American Nat'l Bank v. Fountain, 148 N.C. 590, 62 S.E. 738 (1908); Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914); First Nat'l Bank v. Warsaw Drug Co., 166 N.C. 99, 81 S.E. 993 (1914); Smathers v. Toxaway Hotel Co., 168 N.C. 69, 84 S.E. 47 (1915); Moon v. Simpson, 170 N.C. 335, 87 S.E. 118 (1915); Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926); Hooker

v. Hardee, 192 N.C. 229, 134 S.E. 485 (1926).

The burden rests upon the holder, when the title of a prior holder is shown to be defective, to show lack of knowledge of the defect. Standard Inv. Co. v. Town of Snow Hill, 78 F.2d 33 (4th Cir. 1935).

Since Defective Title Rebutted Presumption. — The presumption that every holder was a holder in due course did not apply when it was alleged and shown that the negotiable instrument was indorsed by one whose title was defective. American Exch. Nat'l Bank v. Seagroves, 166 N.C. 608, 82 S.E. 947 (1914); Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926).

Denial of Plaintiff's Ownership Did Not Rebut Presumption. — Prima facie case was not rebutted by a mere denial in the answer of the ownership of the plaintiff. Causey v. Snow, 120 N.C. 279, 26 S.E. 775 (1897); Gulf States Steel Co. v. Ford, 173 N.C. 195, 91 S.E. 844 (1917).

Burden Shifted on Proof or Admission of Fraud or Infirmity. — A holder of a note, to show that he is a holder in due course without notice, must do so by the greater weight of the evidence when the maker pleads and shows fraud, infirmity or defective title. American Nat'l Bank v. Fountain, 148 N.C. 590, 62 S.E. 738 (1908); Myers v. Petty, 153 N.C. 462, 69 S.E. 417 (1910); Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914); Smathers v. Toxaway Hotel Co., 168 N.C. 69, 84 S.E. 47 (1915); Metropolitan Disct. Co. v. Baker, 176 N.C. 546, 97 S.E. 495 (1918); Hooker v. Hardee, 192 N.C. 229, 134 S.E. 485 (1926).

Where fraud on the part of the payee in the procurement and issuance of the instrument was shown, the burden of providing due course is shifted to the holder. Myers v. Petty, 153 N.C. 462, 69 S.E. 417 (1910); Third Nat'l Bank v. Exum, 163 N.C. 199, 79 S.E. 498 (1913); Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914); American Exch. Nat'l Bank v. Seagroves, 166 N.C. 608, 82 S.E. 947 (1914); Bank of Varina v. Sherron, 186 N.C. 297, 119 S.E. 497 (1923); Hooker v. Hardee, 192 N.C. 229, 134 S.E. 485 (1926); Whitfield v. Carolina Hous. & Mtg. Corp., 243 N.C. 658, 92 S.E.2d 78 (1956). This rule also applied where the holder admitted infirmities in the instrument. Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926).

Upon proof of fraud in the inception of the contract, the burden shifts to the holder of a negotiable instrument to show that he is a holder in due course for value and without notice of the infirmity. Hancammon v. Carr, 229 N.C. 52, 47 S.E.2d 614 (1948).

When a holder of a note admits certain infirmities in the note, in an action to recover on the note, the burden is upon him to show that he is a holder in due course. Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926).

The holder of a negotiable note is presumed to be a holder in due course, but, when the note's execution is proved to have been obtained by fraud, the burden then shifts to him to prove that he took it before maturity, for value and without notice. Williams v. Green, 23 F.2d 796 (4th Cir. 1928).

It was competent for the defendant to introduce evidence as to the quality of goods for which a draft was accepted in order that he might show fraud and deception, and where such proof was admitted the burden of proving holding in due course devolved upon holder. Campbell v. Patton, 113 N.C. 481, 18 S.E. 687 (1893); Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906); American Nat'l Bank v. Fountain, 148 N.C. 590, 62 S.E. 738 (1908); Park v. Exum, 156 N.C. 228, 72 S.E. 309 (1911); Standing Stone Nat'l Bank v. Walser, 162 N.C. 53, 77 S.E. 1006 (1913); Fidelity Trust Co. v. Ellen, 163 N.C. 45, 79 S.E. 263 (1913); Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914); Smathers v. Toxaway Hotel Co., 168 N.C. 69, 84 S.E. 47 (1915); Metropolitan Disct. Co. v. Baker, 176 N.C. 546, 97 S.E. 495 (1918).

Burden of Proving Title on Intervener Bank. — Where a forwarding bank intervened and claimed title to a draft of a nonresident debtor attached in the hands of a local bank, the burden was on the intervener to show its title to the property attached. Sterling Mills, Inc. v. Saginaw Milling Co., 184 N.C. 461, 114 S.E. 756 (1922).

Holder Must Prove Indorsement Before Maturity. — A holder by indorsement had to show the instrument had been indorsed before maturity. Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906).

Indorsement by Rubber Stamp Does Not Prove Itself. — An indorsement by a rubber stamp is a valid endorsement but does not prove itself. Mayers v. McRimmon, 140 N.C. 640, 53 S.E. 447 (1906).

Credibility of Holder's Evidence Is for Jury. — The credibility of the plaintiff's evidence that he is a holder in due course is for the jury. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906); American Nat'l Bank v. Fountain, 148 N.C. 590, 62 S.E. 738 (1908); Park v. Exum, 156 N.C. 228, 72 S.E. 309 (1911); Standing Stone Nat'l Bank v. Walser, 162 N.C. 53, 77 S.E. 1006 (1913); Fidelity Trust Co. v. Ellen, 163 N.C. 45, 79 S.E. 263 (1913).

§ 25-3-309. Enforcement of lost, destroyed, or stolen instrument.

(a) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under subsection (a) of this section must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, G.S. 25-3-308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means. (1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-309 is a modification of former Section 3-804. The rights stated are those of "a person entitled to enforce the instrument" at the time of loss rather than those of an "owner" as in former Section 3-804. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3-804 allowed the court to "require security indemnifying the defendant against loss." Under Section 3-309 adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

§ 25-3-310. Effect of instrument on obligation for which taken.

(a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in subsection (a) of this section, if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in subdivision (4), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in subsection (a) or (b) of this section is taken for an obligation, the effect is (i) that stated in subsection (a) of this section if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in subsection (b) of this section in any other case. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-310 is a modification of former Section 3-802. As a practical matter, application of former Section 3-802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) and (b) of Section 3-310 are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the exception in former Section 3-802 for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3-802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3-802(1)(b) that the buyer's obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

The last sentence of subsection (b)(3) applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer's liability as indorser is discharged. Section 3-415(e). Under the last sentence of Section 3-310(b)(3) Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3-802 to the case in

which the check given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section 3-602(a). The payee's cause of action is against the depositary bank or payor bank in conversion under Section 3-420 or against the drawer under Section 3-309. In the latter case, the drawer's obligation under Section 3-414(b) is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3-504(a)(i) and, under Section 3-502(e), dishonor occurs without presentment if the check is not paid. The payee cannot merely ignore the instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b). If the creditor then loses the check, what are the creditor's rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3-309 to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) applies and the obligation is discharged. In any other case subsection (b) applies.

Legal Periodicals. — For note, "Transfers by Check: The 90-Day Rule of Preference Recovery Under Section 547(b) of the Bankruptcy Code," see 1987 Duke L.J. 712.

CASE NOTES

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Evidence Showing Payment in Full of Underlying Obligations. — Evidence was sufficient to show that there had been payment in full of underlying obligations pursuant to subdivision (1)(a) where the checks in question were indorsed to lender and he indorsed the checks in blank, annotations on each check noted that the check was in payment of the amounts due on the loans (the underlying obligations), and lender received a check constituting partial satisfaction of the debt and a deposit slip showing a deposit into lender's account in the amount of the remainder. In re Foreclosure of First Resort Properties of N.C., Inc., 94 N.C. App. 99, 380 S.E.2d 124, aff'd, 326 N.C. 357, 388 S.E.2d 769 (1990).

Cited in Spector United Employees Credit Union v. Smith, 45 N.C. App. 432, 263 S.E.2d 319 (1980).

§ 25-3-311. Accord and satisfaction by use of instrument.

(a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(b) Unless subsection (c) of this section applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(c) Subject to subsection (d) of this section, a claim is not discharged under subsection (b) of this section when the claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(d) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim. (1899, c. 733, ss. 5, 6, 197; 1905, c. 327; Rev., ss. 2154, 2155, 2346; C.S., ss. 2986, 2987; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

Case #1. The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.

Case #2. A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case #1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated by the buyer, but the seller can't accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1-207 changed the common law rule. The Restatement states that section "need not be read as changing this well-established rule."

3. As part of the revision of Article 3, Section 1-207 has been amended to add subsection (2) stating that Section 1-207 "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3, Section 3-311 governs full satisfaction checks. Section 3-311 follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3-311 there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section 3-311 is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) states three requirements for application of Section 3-311. "Good faith" in subsection (a)(i) is defined in Section 3-103(a)(4) as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of "fair dealing" will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in

relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i).

Section 3-311 does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii). Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) are met. If that person also proves that the statement required by subsection (b) was given, the claim is discharged unless subsection (c) applies. Normally the statement required by subsection (b) is written on the check. Thus, the canceled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) requires a "conspicuous" statement that the instrument was tendered in full satisfaction of the claim. "Conspicuous" is defined in Section 1-201(10). The statement is conspicuous if "it is so written that a reasonable person against whom it is to operate ought to have noticed it." If the claimant can reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant's indorsement of the check, the claimant "ought to have noticed" the statement.

5. Subsection (c)(1) is a limitation on subsection (b) in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4-205(a). Subsection (c)(1) allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) applies.

6. Subsection (c)(2) is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1). Some organizations may be reluctant to use subsection (c)(1) because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2). If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) is subject to subsection (d). If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by "the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation," the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1), or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2).

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant "has actual knowledge" of that fact. Section 1-201(25). Under Section 1-201(27), if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is

> "brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

With respect to an attempted accord and satisfaction the "individual conducting that transaction" is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1), that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain store subsection (d) would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive's personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer's account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full-satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of "due diligence" under Section 1-201(27) if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3-311(c) is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) or (2) without burdening the check-processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the "agent of the claimant" in subsection (d) refers to an agent of the assignee.

NORTH CAROLINA COMMENT

This section differs from Section 3-311 of Revised Article 3 in that subdivision (c)(2) was deleted by the General Assembly.

Cross References. — For definition of "organization," see G.S. 25-1-201 (28).

CASE NOTES

Requirement of Claim to Be Unliquidated or Subject to Bona Fide Dispute. — Person against whom a claim is asserted must prove, inter alia, that the amount of the claim is unliquidated or subject to a bona fide dispute prior to submission of the instrument representing full and final payment under G.S. 25-3-311(a). Hunter-McDonald, Inc. v. Edison Foard, Inc., 157 N.C. App. 560, 579 S.E.2d 490, 2003 N.C. App. LEXIS 733 (2003), cert. denied, 357 N.C. 459, 585 S.E.2d 759 (2003).

Debtor Seeking to Pay Less Than Amount Owed. — Regarding whether the claim is unliquidated or subject to a bona fide dispute as required by G.S. 25-3-311(a)(ii), G.S. 25-3-311 does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute; according to G.S. 25-3-311 cmt. 4, other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. Hunter-McDonald, Inc. v. Edison Foard, Inc., 157 N.C. App. 560, 579 S.E.2d 490, 2003 N.C. App. LEXIS 733 (2003), cert. denied, 357 N.C. 459, 585 S.E.2d 759 (2003).

Requirements of G.S. 25-3-311(a)-(b). — Reading G.S. 25-3-311(a)-(b) together, payor bears the burden of proving: (1) payor in good faith tenders an instrument to the payee as full satisfaction of the claim; (2) the instrument or an accompanying written communication contains a conspicuous statement stating it is tendered as full satisfaction of the claim; (3) the claim is unliquidated or subject to a bona fine dispute; and (4) the payee obtained payment of the instrument. Hunter-McDonald, Inc. v. Edison Foard, Inc., 157 N.C. App. 560, 579 S.E.2d 490, 2003 N.C. App. LEXIS 733 (2003), cert. denied, 357 N.C. 459, 585 S.E.2d 759 (2003).

Material Fact Issue as to Bona Fide Dispute. — Appeals court reversed the summary judgment because there remained a genuine issue of material fact whether an amount due was unliquidated or in bona fide dispute when the contractor paid the subcontractor $11,500 as its full and final payment. Hunter-McDonald, Inc. v. Edison Foard, Inc., 157 N.C. App. 560, 579 S.E.2d 490, 2003 N.C. App. LEXIS 733 (2003), cert. denied, 357 N.C. 459, 585 S.E.2d 759 (2003).

Cited in Futrelle v. Duke Univ., 127 N.C. App. 244, 488 S.E.2d 635 (1997).

§ 25-3-312. Lost, destroyed, or stolen cashier's check, teller's check, or certified check.

(a) In this section:

(1) "Check" means a cashier's check, teller's check, or certified check.

(2) "Claimant" means a person who claims the right to receive the amount of a cashier's check, teller's check, or certified check that was lost, destroyed, or stolen.

(3) "Declaration of loss" means a written statement, made under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier's check or teller's check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(4) "Obligated bank" means the issuer of a cashier's check or teller's check or the acceptor of a certified check.

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case of a cashier's check or teller's check, or the 90th day following the date of the acceptance, in the case of a certified check.

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to G.S. 25-4-302(a)(1), payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under subsection (b)(4) of this section and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under subsection (b) of this section and is also a person entitled to enforce a cashier's check, teller's check, or certified check which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or G.S. 25-3-309. (1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section applies to cases in which a cashier's check, teller's check, or certified check is lost, destroyed, or stolen. In one typical case a customer of a bank closes his or her account and takes a cashier's check or teller's check of the bank as payment of the amount of the account. The customer may be moving to a new area and the check is to be used to open a bank account in that area. In such a case the check will normally be payable to the customer. In another typical case a cashier's check or teller's check is bought from a bank for the purpose of paying some obligation of the buyer of the check. In such a case the check may be made payable to the customer and then negotiated to the creditor by indorsement. But often, the payee of the check is the creditor. In the latter case the customer is a remitter. The section covers loss of the check by either the remitter or the payee. The section also covers loss of a certified check by either the drawer or payee.

Under Section 3-309 a person seeking to enforce a lost, destroyed, or stolen cashier's check or teller's check may be required by the court to give adequate protection to the issuing bank against loss that might occur by reason of the claim by another person to enforce the check. This might require the posting of an expensive bond for the amount of the check. Moreover, Section 3-309 applies only to a person entitled to enforce the check. It does not apply to a remitter of a cashier's check or teller's check or to the drawer of a certified check. Section 3-312 applies to both. The purpose of Section 3-312 is to offer a person who loses such a check a means of getting refund of the amount of the check within a reasonable period of time without the expense of posting a bond and with full protection of the obligated bank.

2. A claim to the amount of a lost, destroyed, or stolen cashier's check, teller's check, or certified check may be made under subsection (b) if the following requirements of that subsection are met. First, a claim may be asserted only by the drawer or payee of a certified check or the

remitter or payee of a cashier's check or teller's check. An indorsee of a check is not covered because the indorsee is not an original party to the check or a remitter. Limitation to an original party or remitter gives the obligated bank the ability to determine, at the time it becomes obligated on the check, the identity of the person or persons who can assert a claim with respect to the check. The bank is not faced with having to determine the rights of some person who was not a party to the check at that time or with whom the bank had not dealt. If a cashier's check is issued to the order of the person who purchased it from the bank and that person indorses it over to a third person who loses the check, the third person may assert rights to enforce the check under Section 3-309 but has no rights under Section 3-312.

Second, the claim must be asserted by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check. "Obligated bank" is defined in subsection (a)(4). Third, the communication must be received in time to allow the obligated bank to act on the claim before the check is paid, and the claimant must provide reasonable identification if requested. Subsections (b)(iii) and (iv). Fourth, the communication must contain or be accompanied by a declaration of loss described in subsection (b). This declaration is an affidavit or other writing made under penalty of perjury alleging the loss, destruction, or theft of the check and stating that the declarer is a person entitled to assert a claim, i.e. the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check.

A claimant who delivers a declaration of loss makes a warranty of the truth of the statements made in the declaration. The warranty is made to the obligated bank and anybody who has a right to enforce the check. If the declaration of loss falsely alleges loss of a cashier's check that did not in fact occur, a holder of the check who was unable to obtain payment because subsection (b)(3) and (4) caused the obligated bank to dishonor the check would have a cause of action against the declarer for breach of warranty.

The obligated bank may not impose additional requirements on the claimant to assert a claim under subsection (b). For example, the obligated bank may not require the posting of a bond or other form of security. Section 3-312(b) states the procedure for asserting claims covered by the section. Thus, procedures that may be stated in other law for stating claims to property do not apply and are displaced within the meaning of Section 1-103.

3. A claim asserted under subsection (b) does not have any legal effect, however, until the date it becomes enforceable, which cannot be earlier than 90 days after the date of a cashier's check or teller's check or 90 days after the date of acceptance of a certified check. Thus, if a lost check is presented for payment within the 90-day period, the bank may pay a person entitled to enforce the check without regard to the claim and is discharged of all liability with respect to the check. This ensures the continued utility of cashier's checks, teller's checks, and certified checks as cash equivalents. Virtually all such checks are presented for payment within 90 days.

If the claim becomes enforceable and payment has not been made to a person entitled to enforce the check, the bank becomes obligated to pay the amount of the check to the claimant. Subsection (b)(4). When the bank becomes obligated to pay the amount of the check to the claimant, the bank is relieved of its obligation to pay the check. Subsection (b)(3). Thus, any person entitled to enforce the check, including even a holder in due course, loses the right to enforce the check after a claim under subsection (b) becomes enforceable.

If the obligated bank pays the claimant under subsection (b)(4), the bank is discharged of all liability with respect to the check. The only exception is the unlikely case in which the obligated bank subsequently incurs liability under Section 4-302 (a)(1) with respect to the check. For example, Obligated Bank is the issuer of a cashier's check and, after a claim becomes enforceable, it pays the claimant under subsection (b)(4). Later the check is presented to Obligated Bank for payment over the counter. Under subsection (b)(3), Obligated Bank is not obliged to pay the check and may dishonor the check by returning it to the person who presented it for payment. But the normal rules of check collection are not affected by Section 3-312. If Obligated Bank retains the check beyond midnight of the day of presentment without settling for it, it becomes accountable for the amount of the check under Section 4-302 (a)(1) even though it had no obligation to pay the check.

An obligated bank that pays the amount of a check to a claimant under subsection (b)(4) is discharged of all liability on the check so long as the assertion of the claim meets the requirements of subsection (b) discussed in Comment 2. This is important in cases of fraudulent declarations of loss. For example, if the claimant falsely alleges a loss that in fact did not occur, the bank, subject to Section 1-203, may rely on the declaration of loss. On the other hand, a claim may be asserted only by a person described in subsection (b)(i). Thus, the bank is discharged under subsection (a)(4) only if it pays such a person. Although it is highly unlikely, it is possible that more than one person could assert a claim under subsection (b) to the amount of a check. Such a case could occur if one of the claimants makes a false declaration of loss. The obligated bank is not required to determine whether a claimant who complies with subsection (b) is acting wrongfully. The bank may utilize procedures outside this Article, such as interpleader, under which the conflicting claims may be adjudicated.

Although it is unlikely that a lost check would be presented for payment after the claimant was paid by the bank under subsection (b)(4), it is possible for it to happen. Suppose the declaration of loss by the claimant fraudulently alleged a loss that in fact did not occur. If the claimant negotiated the check, presentment for payment would occur shortly after negotiation in almost all cases. Thus, a fraudulent declaration of loss is not likely to occur unless the check is negotiated after the 90-day period has already expired or shortly before expiration. In such a case the holder of the check, who may not have noticed the date of the check, is not entitled to payment from the obligated bank if the check is presented for payment after the claim becomes enforceable. Subsection (b)(3). The remedy of the holder who is denied payment in that case is an action against the claimant under subsection (c) if the holder is a holder in due course, or for breach of warranty under subsection (b). The holder would also have common law remedies against the claimant under the law of restitution or fraud.

4. The following cases illustrate the operation of Section 3-312:

Case #1. Obligated Bank (OB) certified a check drawn by its customer, Drawer (D), payable to Payee (P). Two days after the check was certified, D lost the check and then asserted a claim pursuant to subsection (b). The check had not been presented for payment when D's claim became enforceable 90 days after the check was certified. Under subsection (b)(4), at the time D's claim became enforceable OB became obliged to pay D the amount of the check. If the check is later presented for payment, OB may refuse to pay the check and has no obligation to anyone to pay the check. Any obligation owed by D to P, for which the check was intended as payment, is unaffected because the check was never delivered to P.

Case #2. Obligated Bank (OB) issued a teller's check to Remitter (R) payable to Payee (P). R delivered the check to P in payment of an obligation. P lost the check and then asserted a claim pursuant to subsection (b). To carry out P's order, OB issued an order pursuant to Section 4-403(a) to the drawee of the teller's check to stop payment of the check effective on the 90th day after the date of the teller's check. The check was not presented for payment. On the 90th day after the date of the teller's check P's claim becomes enforceable and OB becomes obliged to pay P the amount of the check. As in Case #1, OB has no further liability with respect to the check to anyone. When R delivered the check to P, R's underlying obligation to P was discharged under Section 3-310. Thus, R suffered no loss. Since P received the amount of the check, P also suffered no loss except with respect to the delay in receiving the amount of the check.

Case #3. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). Two days after issue, the check was stolen from P who then asserted a claim pursuant to subsection (b). Ten days after issue, the check was deposited by X in an account in Depositary Bank (DB). X had found the check and forged the indorsement of P. DB promptly presented the check to OB and obtained payment on behalf of X. On the 90th day after the date of the check P's claim becomes enforceable and P is entitled to receive the amount of the check from OB. Subsection (b)(4). Although the check was presented for payment before P's claim became enforceable, OB is not discharged. Because of the forged indorsement X was not a holder and neither was DB. Thus, neither is a person entitled to enforce the check (Section 3-301) and OB is not discharged under Section 3-602(a). Thus, under subsection (b)(4), because OB did not pay a person entitled to enforce the check, OB must pay P. OB's remedy is against DB for breach of warranty under Section 4-208(a)(1). As an alternative to the remedy under Section 3-312, P could recover from DB for conversion under Section 3-420(a).

Case #4. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). X found the check and deposited it in X's account in Depositary Bank (DB) after indorsing the check. DB presented the check for payment before the end of the 90-day period after its date. OB paid the check. Because of the unrestricted blank indorsement by P, X became a holder of the check. DB also became a holder. Since the check was paid before P's claim became enforceable and payment was made to a person entitled to enforce the check, OB is discharged of all liability with respect to the check. Subsection (b)(2). Thus, P is not entitled to payment from OB. Subsection (b)(4) doesn't apply.

Case #5. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). At the end of the 90-day period after the date of the check, OB paid the amount of the check to P under subsection (b)(4). X then found the check and deposited it to X's account in Depositary Bank (DB). DB presented the check to OB for payment. OB is not obliged to pay the check. Subsection (b)(4). If OB dishonors the check, DB's remedy is to charge back X's account. Section 4-214(a). Although P, as an indorser, would normally have liability to DB under Section 3-415(a) because the check was dishonored, P is released from that liability under Section 3-415(e) because collection of the check was initiated more than 30 days after the indorsement. DB has a remedy only against X. A depositary bank that takes a cashier's check that cannot be presented for payment before expiration of the 90-day period after its date is on notice that the check might not be paid because of the possibility of a claim asserted under subsection (b) which would excuse the issuer of the check from paying the check. Thus, the depositary bank cannot safely release funds with respect to the check until it has assurance that the check has been paid. DB cannot be a holder in due course of the check because it took the check when the check was overdue. Section 3-304(a)(2). Thus, DB has no action against P under subsection (c).

Case #6. Obligated Bank (OB) issued a cashier's check payable to bearer and delivered it to its customer, Remitter (R). R held the check for 90 days and then wrongfully asserted a claim to the amount of the check under subsection (b). The declaration of loss fraudulently stated that the check was lost. R received payment from OB under subsection (b)(4). R then negotiated the check to X for value. X presented the check to OB for payment. Although OB, under subsection (b)(2), was not obliged to pay the check, OB paid X by mistake. OB's teller did not notice that the check was more than 90 days old and was not aware that OB was not obliged to pay the check. If X took the check in good faith, OB may not recover from X. Section 3-418(c). OB's remedy is to recover from R for fraud or for breach of warranty in making a false declaration of loss. Subsection (b).

PART 4.

LIABILITY OF PARTIES.

§ 25-3-401. Signature.

(a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under G.S. 25-3-402.

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing. (1899, c. 733, s. 18; Rev., s. 2167; C.S., s. 2999; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3-402. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay ***" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3-204(d).

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

Legal Periodicals. — For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

For article, "The Basic Principle of Loss Allocation for Unauthorized Checks," see 39 Wake Forest L. Rev. 453 (2004).

CASE NOTES

This section does not affect the liability of a nonsigner in connection with an original obligation for which the instrument was later given on other circumstances relating to the same transactions. North Carolina Nat'l Bank v. Wallens, 31 N.C. App. 721, 230 S.E.2d 690 (1976), decided under former UCC Article 3.

Name in Body of Instrument Is Not Necessary. — It is not necessary that the name of the obligor appear in the note; it is sufficient that he sign it. Howell v. Parsons, 89 N.C. 230 (1883), decided under former statutory provisions.

§ 25-3-402. Signature by representative.

(a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to subsection (c) of this section, if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity, or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person. (1899, c. 733, ss. 19 to 21; Rev., ss. 2168 to 2170; C.S., ss. 3000 to 3002; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states when the represented person is bound on an instrument if the instrument is signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3-401(1) stated that "no person is liable on an instrument unless his signature appears thereon." This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P's behalf and A signed A's name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the person entitled to enforce the note can also prove that P authorized A to sign on P's behalf, why shouldn't P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former Section 3-401(1) if an authorized agent signed "as agent" but the note did not identify the principal. If the dispute was between the agent and the payee of the note, the agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3-403(2)(b). Under the prevailing interpretation of former Section 3-401(1), the principal was not liable on the note under former Section 3-401(1) because the principal's name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3-402(a) the principal would be liable on the note.

2. Subsection (b) concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3-403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) states that if the form of the signature unambiguously shows that it is made on behalf of an identified represented person (for example, "P, by A, Treasurer") the agent is not liable. This is a workable standard for a court to apply. Subsection (b)(2) partly changes former Section 3-403(2). Subsection (b)(2) relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1). The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case #1. Doe signs "John Doe" without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case #2. Doe signs "John Doe, Agent" but the note does not identify Richard Roe as the represented person.

Case #3. The name "Richard Roe" is written on the note and immediately below that name Doe signs "John Doe" without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases does Doe's signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a). If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3-403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent's name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3-403(2)(a) even though both parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) changes the result of those cases, and is consistent with Section 3-117 which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3-403 spoke of the represented person being "named" in the instrument. Section 3-402 speaks of the represented person being "identified" in the instrument. This change in terminology is intended to reject decisions under former Section 3-403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule cases decided under former Article 3 such as *Griffin v. Ellinger,* 538 S.W.2d 97 (Texas 1976).

Cross References. — As to burden of establishing signatures, defenses and due course, see G.S. 25-3-307.

Legal Periodicals. — For survey of 1976 case law on commercial law, see 55 N.C.L. Rev. 943 (1977).

CASE NOTES

I. Decisions Under Prior Version of Article 3.
II. Decisions Under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Burden on Signing Party to Avoid Personal Obligation. The clear intent of the statute is that the signing party has the burden to otherwise establish, else he incurs the personal obligation which the statute imposes. Southern Nat'l Bank v. Pocock, 29 N.C. App. 52, 223 S.E.2d 518, cert. denied, 290 N.C. 94, 225 S.E.2d 324 (1976).

Undisclosed Intention Not to Be Personally Obligated Irrelevant by Itself. — It takes more than an intention of one party undisclosed to the other to establish the requisite understanding between the parties necessary to invoke the exception to personal liability under subdivision (2)(b) of this section. Southern Nat'l Bank v. Pocock, 29 N.C. App. 52, 223 S.E.2d 518, cert. denied, 290 N.C. 94, 225 S.E.2d 324 (1976).

Subdivision (2)(b) allows introduction of parol evidence to establish requisite agency status to avoid personal liability. North Carolina Equip. Co. v. DeBruhl, 28 N.C. App. 330, 220 S.E.2d 867, cert. denied, 289 N.C. 451, 223 S.E.2d 160 (1976).

Subdivision (2)(b) has not been specifically extended to contracts other than negotiable instruments. S & F Trading Co. v. Carson, 87 N.C. App. 602, 361 S.E.2d 897 (1987).

Alter Ego Doctrine Inapplicable. — Evidence establishing that defendant's den was the corporate office, that defendant had not read the corporate bylaws and that he was not familiar with the corporation's tax matters was not sufficient evidence to show that the corporation was "ignored as a separate entity," and was insufficient to apply the alter ego doctrine and hold defendant personally liable. North Carolina Equip. Co. v. DeBruhl, 28 N.C. App. 330, 220 S.E.2d 867, cert. denied, 289 N.C. 451, 223 S.E.2d 160 (1976).

The general rule is that a person cannot escape liability on his unqualified signature by the mere assertion that he signed as a representative of a corporation. S & F Trading Co. v. Carson, 87 N.C. App. 602, 361 S.E.2d 897 (1987).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Authority of Agent May Not Be Lightly Inferred. — The power to bind the principal by the making of negotiable paper is an important one and is not lightly to be inferred. It should be conferred directly, unless by necessary implication the duties of the agent cannot be performed without the exercise of the power, or where the power is practically indispensable to accomplish the object of the agency, and the person dealing with the agent must see to it that his authority is adequate. Bank of Morganton v. Hay, 143 N.C. 326, 55 S.E. 811 (1906).

But Power to Indorse May Be Implied. — The indorsement by an agent is valid even though the power to indorse was conferred in a vague way, and the agency is one by implication. Midgette v. Basnight, 173 N.C. 18, 91 S.E. 353 (1917).

Attorney Collecting Note Is Prima Facie Without Such Power. — An attorney to whom a note is sent for collection has, prima facie, no authority to indorse the same in the name of his client, and the purchaser should inquire as to the extent of the attorney's authority. Sherrill v. Weisiger Clothing Co., 114 N.C. 436, 19 S.E. 365 (1894).

Authority Must Be Proved. — The fact that a signature is by a duly authorized agent does not prove itself, but the facts must be established by proper testimony. Midgette v. Basnight, 173 N.C. 18, 91 S.E. 353 (1917).

Agreement as to Administrator's Personal Liability. — Where an administrator signs a note in the name of the estate and thereunder writes his name as administrator, and at the time of the execution of the note the parties agree that he should not be personally liable thereon, the payee may not hold the administrator personally liable thereon. Bank of Spruce Pines v. Vance, 205 N.C. 103, 170 S.E. 119 (1933).

§ 25-3-403. Unauthorized signature.

(a) Unless otherwise provided in this Article or Article 4, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this Article.

(b) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(c) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this Article which makes the unauthorized signature effective for the purposes of this Article. (1899, c. 733, ss. 9, 23; Rev., ss. 2159, 2171; C.S., ss. 2990, 3003; 1949, c. 953; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. "Unauthorized" signature is defined in Section 1-201(43) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the *** lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3-403(a) deals with the problem by removing the preclusion language that appeared in former Section 3-404.

2. The except clause of the first sentence of subsection (a) states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer's liability is not in damages for breach of warranty of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) clarifies the meaning of "unauthorized" in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section 4-406(f)) barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) refers to "the authorized signature of an organization." The definition of "organization" in Section 1-201(28) is very broad. It covers not only commercial entities but also "two or more persons having a joint or common interest." Hence subsection (b) would apply when a husband and wife are both required to sign an instrument.

Cross References. — For definition of "organization," see G.S. 25-1-201 (28).

CASE NOTES

I. General Consideration.
II. Decisions under Prior Version of Article 3.
III. Decisions under Prior Law.

I. GENERAL CONSIDERATION.

No Relationship Between Indorser and Payee. — Where company did not authorize indorsement of its checks, or payment of the proceeds thereof, to any other entity, there was no agency relationship between the indorser of the checks, which was an entity which was being used to conceal embezzlement of funds, and the company as payee of the checks. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Ratification Defined. — Ratification is defined as the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Ratification as a Matter of Law. — To constitute ratification as a matter of law, the conduct must be consistent with an intent to affirm the unauthorized act and inconsistent with any other purpose. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Ratification may be express or implied, and intent may be inferred from failure to repudiate an unauthorized act or from conduct on the part of the principal which is inconsistent with any other position than intent to adopt the act. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Ratification requires intent to ratify plus full knowledge of all the material facts. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Retention of Benefits as Ratification. — A retention of benefits, with knowledge of his unauthorized signature, by one whose name was signed without authorization may be found to be a ratification. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

What Constitutes Conversion. — Under former G.S. 25-3-419 an instrument was converted when paid over a forged or unauthorized endorsement. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

When an unauthorized signature is ratified, it becomes authorized and conversion is no longer possible. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Negligence Defense. — While a bank had to act in good faith and in accordance with reasonable commercial standards in order to raise a negligence defense under former G.S. 25-3-406, former G.S. 25-3-404 does not require such a showing. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

The initial depository bank which presents a check with a forged indorsement to a collecting or a drawee bank breaches its warranty of good title and, absent an applicable exception becomes liable for the check. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

III. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

A bank is presumed to know the signature of its customers, and if it pays a forged check, it cannot charge the amount to the account of the depositor, unless the depositor is negligent. Yarborough v. Banking Loan & Trust Co., 142 N.C. 377, 55 S.E. 296 (1906).

And Must Establish Agency of One Signing Drafts for Another. — In case of drafts presented for payment by an agent, the bank must be assured of the agency to hold another as principal. Letters of instruction to the agent are not sufficient to show power to draw drafts on the principal. Bank of Morganton v. Hay, 143 N.C. 326, 55 S.E. 811 (1906).

Right of Drawer to Recover from Bank. — Where debtor forged a mortgage and under the forgery obtained a check payable to a third party where he indorsed the check in the name of the third party, and where he paid an outstanding debt to the drawer/creditor with a part of the funds so obtained, in an action against the bank, the drawer/creditor could only recover the difference between the amount of the check and the amount paid to the drawer/creditor. McKaughan v. Trust Co., 182 N.C. 543, 109 S.E. 355 (1921), commented on in 1 N.C.L. Rev. 40.

Maker Held Not Liable to Indorser Who Negligently Failed to Identify Payee. — Where the clerk of the superior court executed a check to the person named in a court order, and the brother of the payee of the check, by fraudulently representing himself to be the payee, took the check to plaintiff and indorsed it in plaintiff's presence by forging the name of his brother, whereupon plaintiff indorsed the check by writing "O.K." and signing his name, plaintiff was not entitled to recover the amount of the check from the clerk individually or in his official capacity, plaintiff's negligence in indorsing the check without attempting to ascertain the identity of the person representing himself to be the payee barring any right to recover. Keel v. Wynne, 210 N.C. 426, 187 S.E. 571 (1936).

§ 25-3-404. Impostors; fictitious payees.

(a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (G.S. 25-3-110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under subsection (a) or (b) of this section, an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which subsection (a) or (b) of this section applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss. (1899, c. 733, s. 9; Rev., s. 2159; C.S., s. 2990; 1949, c. 953; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Under former Article 3, the impostor cases were governed by former Section 3-405(1)(a) and the fictitious payee cases were governed by Section 3-405(1)(b). Section 3-404 replaces former Section 3-405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3-405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 rejects this result. Section 3-404(c) requires only that the indorsement be made in a name "substantially similar" to that of the payee. Subsection (c) also recognizes the fact that checks may be deposited without indorsement. Section 4-205(a).

Subsection (a) changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3-405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3-405. In revised Article 3, Section 3-404(a) gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) is based in part on former Section 3-405(1)(b) and in part on N.I.L. § 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b):

> *Case #1.* Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a non-existent company. Subsection (b) applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer endorses the check in the name "Supplier Co." and deposits it in Depositary Bank. Under subsection (b)(2) and (c)(i), the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3-301.
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> *Case #2.* Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3-405 rather than Section 3-404(b), but the result is the same. See Case #6 in Comment 3 to Section 3-405.
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> *Case #3.* Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer obtains possession of the check after it is signed. Subsection (b) applies because Treasurer is "a person whose intent determines to whom an instrument is payable" and Treasurer does not intend Supplier Co. to have any interest in the check.

Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name "Supplier Co."

Case #4. Checks of Corporation are signed by a check-writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check-writing machine to produce a check payable to Supplier Co., a non-existent company. Subsection (b)(ii) applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1). Under Section 3-301 Thief, as holder, is the "person entitled to enforce the instrument" even though Thief does not have title to the check and is in wrongful possession of it. Thief endorses the check in the name "Supplier Co." and deposits it in an account in Depositary Bank which Thief opened in the name "Supplier Co." Depositary Bank takes the check in good faith and credits the "Supplier Co." account. Under subsection (b)(2) and (c)(i), the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation's account if there was an agreement with Corporation allowing the bank to debit Corporation's account for payment of checks produced by the check-writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) applies. Under Section 3-110(b) Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case #5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case #4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name "Supplier Co." Thief either endorses the check in a name other than "Supplier Co." or does not indorse the check at all. Under Section 4-205(a) a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer endorses. Subsection (c)(ii) treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe's signature, there is no breach of warranty under Section 3-417(a)(3) or 4-208 (a)(3). Because the check was a forged check the drawee bank is not entitled to charge Corporation's account unless Section 3-406 or Section 4-406 applies.

3. In cases governed by subsection (a) the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section 3-418 the drawee bank is not entitled to recover from Depositary Bank on the basis of payment by mistake because Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3-417(a)(1) or (3) or 4-208(a)(1) or (3). Unless Section 3-406 applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the drawer of the check rather than on the drawee or the depositary bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3-103(a)(7). An example of the type of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in Comment 4 to Section 3-405. That Comment addresses the last sentence of Section 3-405(b) which is similar to Section 3-404(d).

In Case #1, Case #2, and Case #3, there was no forgery of the drawer's signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3-418 and Sections 3-417(a)(3) and 4-208(a)(3). This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) applies to those cases. If the depositary bank failed to exercise ordinary care and the failure substantially contributed to the loss, the drawer in Case #4 or the drawee bank in Case #5 has a cause of action against the depositary bank under subsection (d). Comment 4 to Section 3-405 can be used as a guide to the type of conduct that could give rise to recovery under Section 3-404(d).

Legal Periodicals. — For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

CASE NOTES

Editor's Note. — *The cases cited below were decided under this article of the Uniform Commercial Code prior to its 1995 revision.*

Collecting Bank Presenting Forged Indorsement. — A collecting bank does not breach its warranty of good title by presenting a check with a forged, but "effective," indorsement to a drawee bank. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991), decided under former version of UCC Article 3.

For the loss with regard to a forged indorsement to be placed on the drawer, three conditions must be satisfied: (1) an agent or employee must supply the name of the payee to the drawer, (2) intending that the payee have no interest in the check, and (3) forge an indorsement in the name of the intended payee. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991), decided under former version of UCC Article 3.

Where Drawer Intends Imposter to Take Possession as Payee. — Where the drawer, mistaken as to the identity of the person to whom he delivers a check, nevertheless intends that the procurer himself shall take title and possession as payee, the endorsement of the imposter will be regarded as genuine as to subsequent persons dealing in good faith with the instrument, and the bank is protected. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966), decided under former statutory provisions.

§ 25-3-405. Employer's responsibility for fraudulent indorsement by employee.

(a) In this section:

(1) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(2) "Fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) "Responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under subsection (b) of this section, an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person. (1899, c. 733, s. 9; Rev., s. 2159; C.S., s. 2990; 1949, c. 953; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-405 is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3-405 adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3-405 is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b)

allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss. "Ordinary care" is defined in Section 3-103(a)(7). The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3-405 are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3-405 includes cases that were covered by former Section 3-405(1)(c). The scope of Section 3-405 in revised Article 3 is, however, somewhat wider. It covers some cases not covered by former Section 3-405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case #6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3-405. The key provision is the definition of "responsibility" in subsection (a)(1) which identifies the kind of responsibility delegated to an employee which will cause the employer to take responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3-405 — fraudulent indorsements of the name of the employer to instruments payable to the employer — were covered in former Article 3 by Section 3-406. Under former Section 3-406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3, Section 3-406 need not be used with respect to forgeries of the employer's indorsement. Section 3-405 imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3-405(1)(c), Section 3-405 is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3-405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised Section 3-405 the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3-404(b) and Section 3-405 both apply to cases of employee fraud. Section 3-404(b) is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3-405. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case #1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer's offices. Janitor forges Employer's indorsement on the check and obtains payment. Since Janitor was not entrusted with "responsibility" with respect to the check, Section 3-405 does not apply. Section 3-406 might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for conversion against the depositary or payor bank under Section 3-420.

Case #2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section 3-402(a). Section 3-405 does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3-110(a).

Case #3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer's indorsement. The check is deposited by Employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer's indorsement because Employee's duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with "responsibility" with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4-205(a). Under subsection (c) deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case #4. Employee's duties include stamping Employer's unrestricted blank indorsement on checks received by Employer and depositing them in Employer's bank account. After stamping Employer's unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee's personal bank account. Section 3-405 doesn't apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer's checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3-307.

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a check to be issued to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co., and deposited it to an account in Depositary Bank which Employee opened in the name "Supplier Co." The check was honored by the drawee bank. The indorsement is effective under Section 3-405(b) because Employee's duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3-417(a)(1) or 4-208(a)(1).

Case #6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to Supplier Co., a company that sold goods to Corporation. The check was issued to pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name "Supplier Co." and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name "Supplier Co.". The indorsement is effective under Section 3-405(b). Section 3-404(b) does not apply to this case.

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk's duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co., a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(i) does not apply to this case because Clerk, under Section 3-110(a), is not the person whose intent determines to whom the check is payable. But Section 3-405 does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3-404(b)(ii) applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3-417(1)(a).

4. The last sentence of subsection (b) is similar to subsection (d) of Section 3-404 which is discussed in Comment 3 to Section 3-404. In Case #5, Case #6, or Case #7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name "Supplier Co.," to deposit checks payable to "Supplier Co." in that account, or to withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check. If the trier of fact finds that there was such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) can be illustrated by an example. Suppose in Case #5 that the check is not payable to an obscure "Supplier Co." but rather to a well-known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation's board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives

payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

CASE NOTES

I. General Consideration.
II. Decisions under Prior Version of Article 3.

I. GENERAL CONSIDERATION.

Effect of 1995 Amendment. — The phrase "in the name of a named payee" in the version of this section prior to the 1995 amendment was clarified by the amendment, and required an indorsement not identical to the name of the payee, but rather "substantially similar" to it. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

Application of this section was precluded where the indorser of a check could not be characterized as substantially similar to the named payee; the addition of certain words signified that the indorser was an entity distinct from the named payee. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The case cited below was decided under this article of the Uniform Commercial Code prior to its 1995 revision.*

Agency Required for former § 25-3-405(1)(c) to Apply. — It is the existence of an agency relationship, not the scope of the agency, which is required for former G.S. 25-3-405(1)(c). Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991) decided under former version of UCC Article 3.

§ 25-3-406. Negligence contributing to forged signature or alteration of instrument.

(a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) Under subsection (a) of this section, if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(c) Under subsection (a) of this section, the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (b) of this section, the burden of proving failure to exercise ordinary care is on the person precluded. (1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-406(a) is based on former Section 3-406. With respect to alteration, Section 3-406 adopts the doctrine of *Young v. Grote,* 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3-406 the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any "person who, in good faith, pays the instrument or takes it for value or for collection." Section 3-406 rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instru-

ment and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3-407 a person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substantially contributes to an alteration, this section gives the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute "failure to exercise ordinary care [that] substantially contributes to an alteration." Rather, "ordinary care" is defined in Section 3-103(a)(7) in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3-406 does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3-406 applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3-406 refers to "forged signature" rather than "unauthorized signature" that appeared in former Section 3-406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3-406 is not necessary in those cases.

The "substantially contributes" test of former Section 3-406 is continued in this section in preference to a "direct and proximate cause" test. The "substantially contributes" test is meant to be less stringent than a "direct and proximate cause" test. Under the less stringent test the preclusion should be easier to establish. Conduct "substantially contributes" to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of "substantially contributes" in former Section 3-406 by the court in *Thompson Maple Products v. Citizens National Bank of Corry,* 234 A.2d 32 (Pa. Super. Ct. 1967), states what is intended by the use of the same words in revised Section 3-406(b). Since Section 3-404(d) and Section 3-405(b) also use the words "substantially contributes" the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3-406(a):

Case #1. Employer signs checks drawn on Employer's account by use of a rubber stamp of Employer's signature. Employer keeps the rubber stamp along with Employer's personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer's account. The checks are signed by use of the rubber stamp. If Employer demands that Employer's account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer's signature by the unauthorized use of the rubber stamp.

Case #2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3-110(a). The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case #3. A company writes a check for $10. The figure "10" and the word "ten" are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the check, using a typewriter with a typeface similar to that used on the check, writes the word "thousand" after the word "ten" and a comma and three zeros after the figure "10". The drawee bank in good faith pays $10,000 when the check is presented for payment and debits the account of the drawer in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check for collection. An example is a case like Case #1 of Comment 3 to Section 3-405. If the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) of Section 3-406 applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a). But suppose the forger opened an account in the depositary bank in a name identical to that of Employer, the payee of the check, and then deposited the check in the account. Subsection (b) may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

Legal Periodicals. — For note on estoppel and forged indorsements under the Uniform Commercial Code, see 47 N.C.L. Rev. 256 (1968).

For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Version of Article 3.

I. GENERAL CONSIDERATION.

Cause of Action. — G.S. 25-3-406 provides for a defense but does not expressly create a cause of action. Wachovia Bank, N.A. v. FRB, 338 F.3d 318, 2003 U.S. App. LEXIS 15014 (4th Cir. 2003).

Did Not Establish Failure to Exercise Ordinary Care. — Presenting bank failed to establish a check drawer's failure to exercise ordinary care as a defense to breach of warranty claims brought against the presenting bank by a paying bank with respect to an altered check; the check drawer's failure to take certain precautions, such as using electronic funds transfer instead of mailing a check, did not amount to a failure of ordinary care that substantially contributed to the alteration. Wachovia Bank, N.A. v. FRB, 338 F.3d 318, 2003 U.S. App. LEXIS 15014 (4th Cir. 2003).

Cited in Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

II. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Former § 25-3-404 Compared. — While a bank must act in good faith and in accordance with reasonable commercial standards in order to raise a negligence defense under this section, former G.S. 25-3-404 does not require such a showing. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 355, 294 S.E.2d 369 (1982).

Action Under Former Section Compared to Former § 25-3-419 Action. — Where the gravaman of a plaintiff's complaint was that a defendant bank paid over funds to a person who illegally opened a joint account in her and the plaintiff's name on a fraudulent endorsement and failed to adhere to the reasonable commercial standards applicable to banking institutions, such an action was properly grounded in conversion as set forth in former G.S. 25-3-419, as opposed to negligence. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Applicable Standard of Conduct for Notifying Payors. — Section 25-4-406 makes provision for notifying a bank of unauthorized checks within certain time periods after bank statements have been received in order to hold the bank liable, and this is a standard of reasonable conduct which should also apply in regard to notifying other payors pursuant to this section. Hartford Accident & Indem. Co. v. Dean's Shop-Rite, Inc., 48 N.C. App. 615, 269 S.E.2d 282 (1980).

§ 25-3-407. Alteration.

(a) "Alteration" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(b) Except as provided in subsection (c) of this section, an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(c) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. (1899, c. 733, ss. 14, 15, 124, 125; Rev., ss. 2164, 2165, 2274, 2275; C.S., ss. 2995, 2996, 3106, 3107; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This provision restates former Section 3-407. Former Section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3-407 refers to such a change as an alteration. As under subsection (2) of former Section 3-407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right of recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase "or is precluded from asserting the alteration" in subsection (b) recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

CASE NOTES

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Material Alteration Avoids Bond. — If the payee of a bond alters it in any material part, without the consent of the obligor, the bond is avoided and may be defeated on the plea of non est factum. Mathis v. Mathis, 20 N.C. 55 (1838); Davis v. Coleman, 29 N.C. 424 (1847); Dunn v. Clements, 52 N.C. 58 (1859); Darwin v. Rippey, 63 N.C. 318 (1869).

Adding "In Specie" Is Material Alteration. — Adding the words "in specie" after the word "dollars" in a note is a material alteration. Darwin v. Rippey, 63 N.C. 318 (1869).

As Is Substituting Name of Maker. — The cutting off of the name of one of the makers of a promissory note and substituting that of another was a material alteration of the note and vitiated it. Davis v. Coleman, 29 N.C. 424 (1847).

Or Substituting Name of Prior Indorser. — Where the payee of a negotiable instrument acquired it with certain indorsers thereon and subsequently struck out the name of the indorser, and another signed as indorser in lieu of the indorser whose name was stricken out, the change was a material one under the NIL and released the indorsers who had not consented to the substitution, but did not release those indorsers whose consent had been procured. Efird v. Little, 205 N.C. 583, 172 S.E. 198 (1934).

What Are Immaterial Alterations. — An addition that does not vary the terms of the contract and adds nothing more than is already implied by law is not sufficient to be construed as a material alteration. Houston v. Potts, 64 N.C. 33 (1870).

Liability Where Amount Left Blank. — See McArthur v. McLeod, 51 N.C. 475 (1859); Humphreys v. Finch, 97 N.C. 303, 1 S.E. 870 (1887); Phillips v. Hensley, 175 N.C. 23, 94 S.E. 673 (1917).

Liability Where Payee's Name Left Blank. — A bill of exchange drawn and issued in blank for the name of the payee may be filled up by a bona fide holder with his own name and will bind the drawer. Lawrence v. Mabry, 13 N.C. 473 (1830).

Same — Acknowledgment after Completion. — If the maker of a sealed note, blank as to the payee's name, acknowledges it to be his bond after the insertion of the payee's name and delivery, it is valid and its maker is liable thereon. Wester v. Bailey, 118 N.C. 193, 24 S.E. 9 (1896).

§ 25-3-408. Drawee not liable on unaccepted draft.

A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it. (1899, c. 733, ss. 127, 189; Rev., ss. 2277, 2339; C.S., ss. 3109, 3171; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section is a restatement of former Section 3-409(1). Subsection (2) of former Section 3-409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): "It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument." In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1-103 is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4-302 imposes liability on a payor bank for late return of an item.

Legal Periodicals. — For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For note, "Transfers by Check: The 90-Day Rule of Preference Recovery Under Section 547(b) of the Bankruptcy Code," see 1987 Duke L.J. 712.

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Law.

I. GENERAL CONSIDERATION.

The transfer of a check does not operate as an assignment of money on deposit; therefore, where defendant did not cash check before testatrix's death, the money was never delivered from testatrix to defendant and the attempted gift was incomplete. Creekmore v. Creekmore, 126 N.C. App. 252, 485 S.E.2d 68 (1997).

Gift Incomplete Where Check Not Cashed. — Where defendant did not cash check before testatrix's death, the money was never delivered from testatrix to defendant and the attempted gift was incomplete. Creekmore v. Creekmore, 126 N.C. App. 252, 485 S.E.2d 68 (1997).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Payee Has No Right of Action Against Bank Until Acceptance. — An action cannot be sustained against a bank by the payee of a negotiable check, though the drawer has funds on deposit sufficient for its payment against which the bank has no claim, until after its acceptance by the bank. Commercial Nat'l Bank v. First Nat'l Bank, 118 N.C. 783, 24 S.E. 524 (1896). See also Brantley v. Collie, 205 N.C. 229, 171 S.E. 88 (1933); Marx v. Maddrey, 106 F. Supp. 535 (E.D.N.C. 1952).

The acceptance of a check is the promise of the drawee to pay it, and, until that promise is made, no contractual relation exists between the drawee and the payee. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966).

Acceptance may be evidenced in various ways, as where the bank pays the check without indorsement to some person unauthorized by the payee to receive it and charges the amount to the depositor's account, and where evidence on this point is conflicting an issue is raised for the jury, and a judgment as of nonsuit should be denied. Dawson v. National Bank, 196 N.C. 134, 144 S.E. 833 (1928).

Check Holder Held Assignee of Debt Due Depositor But Without Lien on Deposit. — A depositor is a creditor of a bank, his deposit becoming a part of the general fund, the property of the bank, and subject to assignment by the owners of the bank, and a check holder is, to the extent of his check, the assignee of the depositor's debt due him by the bank, but he has no lien upon the deposit for the amount of this check. A payee or holder of a check has an interest in the deposit as against the drawer, subject to the bank's right to pay outstanding checks before notice. Hawes v. Blackwell, 107 N.C. 196, 12 S.E. 245 (1890).

§ 25-3-409. Acceptance of draft; certified check.

(a) "Acceptance" means the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(b) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(c) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(d) "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (a) of this section or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check. (1899, c. 733, ss. 132 to 138, 161 to 170, 187, 188, 191; Rev., ss. 2282 to 2288, 2311 to 2320, 2337, 2338, 2340; C.S., ss. 2976, 3114 to 3120, 3143 to 3152, 3169, 3170; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. The first three subsections of Section 3-409 are a restatement of former Section 3-410. Subsection (d) adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any

other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3-408. Any liability is for breach of the separate agreement.

CASE NOTES

Editor's Note. — *The cases below were decided under prior statutory provisions.*

Acceptance and Payment Are Different. — Payment is the performance of the drawee's promise — the expected and intended end of the check. Acceptance prolongs the life of the check; payment ends it. Thus, the two are fundamentally different. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966), decided under former statutory provisions.

The acceptance of a check is the promise of the drawee to pay it, and, until that promise is made, no contractual relation exists between the drawee and the payee. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966), decided under former statutory provisions.

Marking Check "Paid" Did Not Constitute "Constructive Acceptance". — The act of a bank in marking a check "paid" and charging it against a depositor's account did not constitute a "constructive acceptance" under former G.S. 25-144. That section provided that "where a drawee to whom a bill is delivered for acceptance destroys the same or refuses within twenty-four hours after such delivery . . . to return the bill accepted or nonaccepted to the holder, he will be deemed to have accepted the same." It contemplated a case where the bill or check was delivered to the drawee for the purpose of procuring an acceptance or certification; it was never intended to apply to an erroneous payment. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966), decided under former statutory provisions.

Certification Is Acceptance. — The certification of a check by the bank on which it is drawn is equivalent to acceptance, and the bank then becomes the debtor to the holder, against whom he may maintain his action. Drewery-Hughes Co. v. Davis, 151 N.C. 295, 66 S.E. 139 (1909), decided under former statutory provisions.

Certification of check did not affect enforcement of agreement between the original parties, made before certification, by which the debtor had agreed to waive or withdraw a condition annexed to the acceptance of his check by the payee that it was to be received by the payee, his creditor, in full compromise of his debt in a larger amount. Drewery-Hughes Co. v. Davis, 151 N.C. 295, 66 S.E. 139 (1909), decided under former statutory provisions.

§ 25-3-410. Acceptance varying draft.

(a) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(b) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(c) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged. (1899, c. 733, ss. 139 to 142; Rev., ss. 2289 to 2292; C.S., ss. 3121 to 3124; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section is a restatement of former Section 3-412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee's obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) the effect of the holder's assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-501(b)(1) states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3-111) which in this case is at the designated bank.

CASE NOTES

Editor's Note. *— The case below was decided under prior statutory provisions.*

Acceptance Qualified as to Time. — Where one accepted a draft on him "payable when I receive funds to the use of the drawer," he became liable when the moneys were placed to his credit, even though he had not taken manual possession thereof. Wallace Bros. v. Douglas, 116 N.C. 659, 21 S.E. 387 (1895), aff'd, 161 U.S. 346, 16 S. Ct. 485, 40 L. Ed. 2d 727 (1896), decided under former statutory provisions.

§ 25-3-411. Refusal to pay cashier's checks, teller's checks, and certified checks.

(a) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(b) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment of a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(c) Expenses or consequential damages under subsection (b) of this section are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law. (1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor's check, but more frequently the debtor buys from a bank a cashier's check or teller's check payable to the creditor. The check is taken by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which

the check is given in payment. In the case of a certified check or cashier's check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3-602). It is also clear that the bank that sells a teller's check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3-411 is designed to discourage this practice.

2. The term "obligated bank" refers to the issuer of the cashier's check or teller's check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3-202. See Comment 2 to Section 3-201. The bank can assert that claim if there is compliance with Section 3-305(c), but the bank is not protected from damages under subsection (b) if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3-602(b)(1). Subsection (c)(iii) refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier's check is payable to "Supplier Co." The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

§ 25-3-412. Obligation of issuer of note or cashier's check.

The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in G.S. 25-3-115 and G.S. 25-3- 407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under G.S. 25-3-415. (1899, c. 733, ss. 60 to 62; Rev., ss. 2209 to 2211; C.S., ss. 3041 to 3043; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3-412 states the obligation of the maker of a note and is consistent with former Section 3-413(1). Section 3-412 also applies to the issuer of a cashier's check or other draft drawn on the drawer. Under former Section 3-118(a), since a cashier's check or other draft drawn on the drawer was "effective as a note," the drawer was liable under former Section 3-413(1) as a maker. Under Section 3-103(a)(6) and 3-104(f) a cashier's check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3-412 as being the same as that of the maker of a note rather than that of the drawer of a draft. Thus, Section 3-412 does not in substance change former law.

2. Under Section 3-105(b) nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3-406, the maker is precluded from asserting the alteration.

§ 25-3-413. Obligation of acceptor.

(a) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in G.S. 25-3-115 and G.S. 25-3-407. The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under G.S. 25-3-414 or G.S. 25-3-415.

(b) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course. (1899, c. 733, ss. 60 to 62; Rev., ss. 2209 to 2211; C.S., ss. 3041 to 3043; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Subsection (a) is consistent with former Section 3-413(1). Subsection (b) has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

***Editor's Note.** — The case cited below was decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Note Executed in Furtherance of Partnership. — Regardless of whether a note was signed by the parties as individuals or as partners, its legal effect was the same. Nevertheless, in a dissolution action, where it appeared that the note was executed in furtherance of the partnership, and that there may have been partnership funds available to satisfy it, the court should have determined the nature of the note and ordered it repaid out of partnership funds if possible. Ludwig v. Walter, 75 N.C. App. 584, 331 S.E.2d 177 (1985).

II. DECISIONS UNDER PRIOR LAW.

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Drawer May Arrest Payment. — A drawer of a draft, ordinarily standing towards subsequent parties as a general indorser, may, by appropriate words appearing on the paper, or by agreement dehors the instrument as to persons affected with notice, retain the right to arrest payment. Murchison Nat'l Bank v. Dunn Oil Mills Co., 150 N.C. 718, 64 S.E. 885 (1909).

As May Restrictive Indorser. — Where a draft or bill is transferred to a bank by restrictive indorsement, as for deposit or for collection, the instrument is taken and held by the bank as agent for the indorser, and for the purpose indicated, and is subject to the right of the indorser to arrest payment or divert the proceeds in the hands of any intermediate or subagent who has taken the paper for like purpose and is affected by the restriction. Murchison Nat'l Bank v. Dunn Oil Mills Co., 150 N.C. 718, 64 S.E. 885 (1909).

Except as to Holder Without Notice of Restrictions. — When a bank, to which a draft appearing on its face to be negotiable is forwarded by another bank, purchases such draft for value, without notice of an agreement restricting its negotiation, the drawer may not stop payment of the draft as against the rights of the bank so holding the paper. Murchison Nat'l Bank v. Dunn Oil Mills Co., 150 N.C. 718, 64 S.E. 885 (1909).

When Liability of Drawee Accrues. — Until the instrument is accepted, the payee or holder of the bill must look to the drawer for his protection. The liability of the drawee to the payee or holder accrues when he makes a valid acceptance of the bill and when it is in the possession or is delivered to one who is entitled to enforce the engagement contained in the acceptance. The legal intendment of the acceptance is that the acceptor engages to pay the instrument according, but only according, to the tenor of his acceptance. It is, in short, a promise to pay. Branch Banking & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961).

Burden on Bank to Prove Signature. — When a check drawn against a depositor of a bank is paid by the bank, in an action to recover deposits, the burden is on the bank to show that the check was signed by the depositor as maker. Yarborough v. Banking Loan & Trust Co., 142 N.C. 377, 55 S.E. 296 (1906).

Drawee Bank Cannot Recover Amount Paid on Forged Check. — Where the cash bank acts in good faith, the drawee cannot recover the amount where it has paid on a forged check. The drawee should know the signature of the drawer, its own depositor, better than the holder. The drawee cannot plead a custom that would entitle it to pay such draft without the signature being genuine. The fact that the cashing bank stamped the check "all prior indorsements guaranteed" makes no difference to the drawee as that guarantee is only applicable to subsequent holders in due course. State Bank v. Cumberland Sav. & Trust Co., 168 N.C. 605, 85 S.E. 5 (1915).

§ 25-3-414. Obligation of drawer.

(a) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in G.S. 25-3-115 and G.S. 25-3-407. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under G.S. 25-3-415.

(c) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(d) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under G.S. 25-3-415(a) and (c).

(e) If a draft states that it is drawn "without recourse" or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (b) of this section to pay the draft if the draft is not a check. A disclaimer of the liability stated in subsection (b) of this section is not effective if the draft is a check.

(f) If (i) a check is not presented for payment or given to a depositary bank for collection within 30 days after its date, (ii) the drawee suspends payments after expiration of the 30-day period without paying the check, and (iii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds. (1899, c. 733, ss. 7, 60 to 62, 70, 89, 118, 129, 143, 144, 150 to 153, 158, 186, 187, 188; Rev., ss. 2157, 2209 to 2211, 2219, 2239, 2268, 2279, 2293, 2294, 2300 to 2303, 2308, 2336, 2337, 2338; C.S., ss. 2988, 3041 to 3043, 3051, 3071, 3100, 3111, 3125, 3126, 3132 to 3135, 3140, 3168, 3169, 3170; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) excludes cashier's checks because the obligation of the issuer of a cashier's check is stated in Section 3-412.

2. Subsection (b) states the obligation of the

drawer on an unaccepted draft. It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to indorser's liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).

3. Under subsection (c) the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3-205(d).

4. Subsection (d) states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3-408. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an indorser, and subsection (d) states the drawer's liability that way. The drawer is liable to pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3-415. The drawer in this case is discharged if notice of dishonor is required by Section 3-503 and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3-413(a).

5. Subsection (e) does not permit the drawer of a check to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3-502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the $1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3-502(e). If the suspension of payments by the drawee bank will result in payment to X of less than the full amount of the $1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds $100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

§ 25-3-415. Obligation of indorser.

(a) Subject to subsections (b), (c), (d), and (e) of this section and to G.S. 25-3-419(d), if an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in G.S. 25-3-115 and G.S. 25-3-407. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(b) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under subsection (a) of this section to pay the instrument.

(c) If notice of dishonor of an instrument is required by G.S. 25-3-503 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under subsection (a) of this section is discharged.

(d) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under subsection (a) of this section is discharged.

(e) If an indorser of a check is liable under subsection (a) of this section and the check is not presented for payment, or given to a depositary bank for collection, within 30 days after the day the indorsement was made, the liability of the indorser under subsection (a) of this section is discharged. (1899, c. 733, ss. 7, 28, 29, 38, 44, 64, 66 to 68, 70, 89, 118, 129, 143, 144, 150 to 153, 158, 186; Rev., ss. 2157, 2176, 2177, 2187, 2193, 2213, 2215 to 2217, 2219, 2239, 2268, 2279, 2293, 2294, 2300 to 2303, 2308, 2336; C.S., ss. 2988, 3008, 3009, 3019, 3125, 3045, 3047 to 3049, 3051, 3071, 3100, 3111, 3125, 3126, 3132 to 3135, 3140, 3168; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) and (b) restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an indorser. It is covered in subsection (c). Regulation CC G.S. 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3-503 states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3-503, subsection (c) of Section 3-415 states that the effect is to discharge the indorser's obligation.

3. Subsection (d) is similar in effect to Section 3-414(c) if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3-414. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a).

4. Subsection (e) modifies former Sections 3-503(2)(b) and 3-502(1)(a) by stating a 30-day rather than a seven-day period, and stating it as an absolute rather than a presumptive period.

Cross References. — As to warranties on presentment and transfer, G.S. 25-3-417.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Presumption as to Order of Liability Unchanged. — The Uniform Commercial Code did not change the North Carolina rule that endorsers are presumed to be liable in the order in which their signatures appear on the instrument. Wilson v. Turner, 29 N.C. App. 101, 223 S.E.2d 539, cert. denied, 290 N.C. 311, 225 S.E.2d 832 (1976).

Borrower as Co-Maker Not Accommodation Party. — Borrower had a real interest in the proceeds of the note that she signed, and was not an accommodation party where she signed the note as a co-maker, and not as an accommodation party, she signed the promissory note, exactly as husband did on a line under the heading of "Borrower" and, by signing the note, subjected herself to liability on its full amount; husband testified that in preparation for the loan, he gave the bank a joint financial statement, and both of them signed a joint note and deed of trust. Butler v. NationsBank, 58 F.3d 1022 (4th Cir. 1995).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Contract of Indorsement Is Separate Contract. — A contract of indorsement is a substantive contract, separable and independent of the instrument on which it appears, and under the NIL, where it was made without qualification and for value it guaranteed to a holder in due course among other things that the instrument, at the time of the indorsement, was a valid and subsisting obligation. Wachovia Bank & Trust Co. v. Crafton, 181 N.C. 404, 107 S.E. 316 (1921).

Which Cannot Be Explained by Parol Except Between Original Parties. — When a payee or regular indorsee thereof writes his name on the back of a note, as between him and a bona fide holder for value and without notice, the law implies that he intended to assume the well-known liability of an indorser, and he will not be permitted to contradict this implication. But this rule does not apply between the original parties to a contract which is not in writing, although there may be the signature of one or more parties to authenticate that some contract was made. Sykes v. Everett, 167 N.C. 600, 83 S.E. 585 (1914).

In an action upon a note by a remote indorsee, who purchased bona fide for full value and without notice, against the payee, who indorsed the note in blank, evidence of an agreement between the payee and his indorsee that he should not be held liable on his indorsement is not admissible. Hill v. Shields, 81 N.C. 250 (1879).

Parol evidence is admissible to show that as between or among themselves parties to a negotiable instrument are liable otherwise than appears prima facie. Citizens Nat'l Bank v. Burch, 145 N.C. 316, 59 S.E. 71 (1907); Sykes v. Everett, 167 N.C. 600, 83 S.E. 585 (1914); Gillam v. Walker, 189 N.C. 189, 126 S.E. 424 (1925); Dillard v. Farmers' Mercantile Co., 190 N.C. 225, 129 S.E. 598 (1925); Lancaster v. Stanfield, 191 N.C. 340, 132 S.E. 21 (1926).

But Parol Evidence of Agreement to Pay from Particular Fund Is Admissible. — Where an unqualified indorsement is supported by a valuable consideration and the maker seeks to enforce the indorser's liability, the indorser may introduce parol evidence of an agreement entered into by the parties contemporaneously with the execution of the note that payment was to be made out of a particular fund, but he may not introduce parol evidence in contradiction of the written terms of the note that he was not to be held liable in any event. Kindler v. Wachovia Bank & Trust Co., 204 N.C. 198, 167 S.E. 811 (1933).

Substituted Indorser Is Liable as General Indorser. — Where an indorser as originally appearing on a negotiable note has his name stricken from the instrument by the payee and another person signs in substitution for him, the liability of the substituted indorser to the payee remains as a general indorser, unaffected by the cancellation and substitution, when his signature is not obtained by misrepresentation that the other indorsers had consented to the substitution and remained bound by the instrument. Efird v. Little, 205 N.C. 583, 172 S.E. 198 (1934).

Indorsement After Maturity. — An indorsee taking after maturity took the title to whatever interest his indorser had, and by the indorsement the indorser made such warranties as were provided by the NIL. Smith v. Godwin, 145 N.C. 242, 58 S.E. 1089 (1907).

Effect of Indorsement Without Recourse. — Where notes were indorsed by the payee named therein, who wrote above his signature on the back of each note the words "without recourse," under the NIL this was a qualified indorsement. Its effect was to constitute the indorser a mere assignor of the title to the note, which he held at the date of the indorsement. It did not impair the negotiable character of the note so indorsed. Evans v. Freeman, 142 N.C. 61, 54 S.E. 847 (1906); Bank of Sampson v. Hatcher, 151 N.C. 359, 66 S.E. 308 (1909); Walter v. Kilpatrick, 191 N.C. 458, 132 S.E. 148 (1926).

Alone, a qualified indorsement was not sufficient notice as to discredit a negotiable instrument under the NIL, but when combined with other suspicious facts it might become evidence to show infirmities. Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914).

An indorsement "without recourse" under the NIL did not impair the negotiability of the instrument, but qualified the indorsement, and where one had acquired a negotiable instrument by an indorsement by a holder without recourse, there was no implied warranty on the part of such indorser. Evans v. Freeman, 142 N.C. 61, 54 S.E. 847 (1906); Walter v. Kilpatrick, 191 N.C. 458, 132 S.E. 148 (1926).

Set-Off of Deposit Against Note. — Where a depositor in an insolvent national bank had indorsed a note on which he was in fact primarily liable, and procured the bank to discount it for his benefit, he was entitled in a suit by the bank's receiver to recover the amount of the note, to set off his deposit in the bank against his liability on the note. Williams v. Coleman, 190 N.C. 368, 129 S.E. 818 (1925).

Contribution Among Indorsers. — An indorser of a negotiable instrument is not subject to contribution among all others who may have indorsed the same, but is only liable to those who are subsequent in date to his indorsement, to the full amount of their payment as an indemnitor. Lancaster v. Stanfield, 191 N.C. 340, 132 S.E. 21 (1926).

An indorser of a negotiable instrument who had paid a judgment obtained thereon in an action against him and the insolvent makers could not, nothing else appearing, recover the amount in his action therefor against a subsequent indorser. Lynch v. Loftin, 153 N.C. 270, 69 S.E. 143 (1910).

§ 25-3-416. Transfer warranties.

(a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(1) The warrantor is a person entitled to enforce the instrument;
(2) All signatures on the instrument are authentic and authorized;
(3) The instrument has not been altered;
(4) The instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor; and
(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) A person to whom the warranties under subsection (a) of this section are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in subsection (a) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach. (1899, c. 733, ss. 65, 69; Rev., ss, 2214, 2218; C.S. ss. 3046, 3050; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) is taken from subsection (2) of former Section 3-417. Subsections (3) and (4) of former Section 3-417 are deleted. Warranties under subsection (a) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3-203(a)) is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument (Section 3-301). Under Section 3-203(b) transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the

instrument the issue of the holder-in-due-course status of the transferee. Subsection (3) of former Section 3-417 which limits this warranty is deleted. The rationale is that while the purpose of a "no recourse" indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1-201(22) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor's liability, to be effective, must appear in the indorsement with words such as "without warranties" or some other specific reference to warranties. But in the case of a check, subsection (c) of Section 3-416 provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) states the measure of damages for breach of warranty. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase "expenses *** incurred as a result of the breach." The intention is to leave to other state law the issue as to when attorney's fees are recoverable.

7. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (d) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

§ 25-3-417. Presentment warranties.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) The draft has not been altered; and

(3) The warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) of this section based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under G.S. 25-3-404 or G.S. 25-3-405 or the drawer is precluded under G.S. 25-3-406 or G.S. 25-4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser, or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) or (d) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach. (1899, c. 733, ss. 65, 69; Rev., ss. 2214, 2218; C.S., ss. 3046, 3050; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section replaces subsection (1) of former Section 3-417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3-417, presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a). All other presentment warranties are stated in subsection (d).

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements. "Person entitled to enforce" is defined in Section 3-301. Subsection (a)(2) is a warranty that there is no alteration. Subsection (a)(3) is a warranty of no knowledge that there is a forged drawer's signature. Subsection (a) states that the warranties are made to the drawee and subsections (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In *Sun 'N Sand, Inc. v. United California Bank,* 582 P.2d 920 (Cal. 1978), the court held that under former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) retains the rule of *Price v. Neal,* 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) applies to presentment for payment in all cases not covered by subsection (a). It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d), there is only one warranty and it is the same as that stated in subsection (a)(1). There are no warranties comparable to subsections (a)(2) and (a)(3) because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to the drawee when the draft was presented for acceptance (Section 3-417(a)(2) and (3)) and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3-417(b). Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented

for payment. Former Section 3-417(1)(b)(iii) and (c)(iii) are not included in revised Section 3-417 because they are unnecessary. Former Section 3-417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3-416(a)(2) and (3).

5. The measure of damages for breach of warranty under subsection (a) is stated in subsection (b). There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses *** resulting from the breach." Subsection (b) provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in *Hartford Accident & Indemnity Co. v. First Pennsylvania Bank,* 859 F.2d 295 (3d Cir. 1988).

6. Subsection (c) applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3-404, 3-405, 3-406, or 4-406. If the drawer's conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer of warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (f) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

CASE NOTES

***Editor's Note.** — The cases below were decided under prior statutory provisions.*

Applicability to Usury. — The provisions of the NIL made as to warranties which prevailed in case of unqualified indorsements referred to lawful transactions, and did not relate to transactions coming within the meaning of the usury laws. Sedbury v. Duffy, 158 N.C. 432, 74 S.E. 355 (1912), decided under former statutory provisions.

When Warranty of Good Title Broken. — A warranty to a person who pays an instrument in good faith that the person who obtains payment has a good title to the instrument or is authorized to obtain payment on behalf of one who has a good title to it is broken if such person claims through the forged instrument of a joint payee having any interest in the proceeds of the paper. First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972), decided under former statutory provisions.

The initial depository bank which presents a check with a forged indorsement to a collecting or a drawee bank breaches its warranty of good title and, absent an applicable exception becomes liable for the check. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991), decided under Article 3 prior to its 1995 revision.

§ 25-3-418. Payment or acceptance by mistake.

(a) Except as provided in subsection (c) of this section, if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to G.S. 25-4-403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in subsection (c) of this section, if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a) of this section, the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by subsection (a) or (b) of this section may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by G.S. 25-3-417, 25-4-208 [25-4-207.1], or 25-4-407.

(d) Notwithstanding G.S. 25-4-215 [25-4-213], if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b) of this section, the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument. (1899, c. 733, s. 62; Rev., s. 2211; C.S., s. 3043; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. This section covers payment or acceptance by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1-103. Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section 3-418 specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) and (c) are consistent with former Section 3-418 and the rule of *Price v. Neal.* The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee's account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier's check or teller's check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer's check to Bank for payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for $10,000 payable to Seller. The The teller failed to discover Buyer's stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section 4-215, Buyer's check was paid by Bank at the time it delivered its cashier's check to Seller. See Comment 3 to Section 4-215. Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was issued for consideration because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover $10,000, the amount of Buyer's check, from Seller under Section 3-418(a). Bank paid Buyer's check by mistake. Seller did not give value for Buyer's check because the promise to deliver goods to Buyer was never performed. Section 3-303(a)(1). And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section 3-418(c) does not apply and Seller is obliged to return $10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section 3-418(a). This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section 3-305(a)(3).

If Bank recovers from Seller under Section 3-418(a), the payment of Buyer's check is treated as unpaid and dishonored. Section 3-418(d). One consequence is that Seller may enforce Buyer's obligation as drawer to pay the check. Section 3-414. Another consequence is that Seller's rights against Buyer on the contract of sale are also preserved. Under Section 3-310(b) Buyer's obligation to pay for the goods was suspended when Seller took Buyer's check and remains suspended until the check is either dishonored or paid. Under Section 3-310(b)(1)* the obligation is discharged when the check is paid. Since Section 3-418(d) treats Buyer's check as unpaid and dishonored, Buyer's obligation is not discharged and suspension of the obligation terminates. Under Section 3-310 (b)(3), Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer.

If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3-418(a) because Seller in that case gave value for Buyer's check. Section 3-418(c). In this case Bank's sole remedy is under Section 4-407 by subrogation.

3. Subsection (b) covers cases of payment or acceptance by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution G.S. 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the check, the bank is entitled to restitution. But G.S. 29 is subject to Restatement of Restitution G.S. 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father's account to cover the check, caused Daughter's account to be credited for $10,000. In fact, Father's account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from Father. Thus, Bank should be permitted to reverse the credit to Daughter's account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check- kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer's credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3-418 to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3-418 is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4-215, it may have a right to recover the payment under Section 3-418. *National Savings & Trust Co. v. Park Corp.*, 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), correctly states the law on the issue under former Article 3. Revised Article 3 does not change the previous law.

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*Previous incorrect cross reference corrected by Permanent Editorial Board action November 1992.

NORTH CAROLINA COMMENT

Subsection (c) is modified by inserting the cross reference "25-4-208 [25-4-207.1]" in the last sentence of the subsection.

Legal Periodicals. — For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Until Acceptance Drawee Is Not Liable. — A drawee (unless also the drawer) becomes liable for the payment of a draft only upon his acceptance thereof. Branch Banking & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961), decided under former statutory provisions.

Where a bank issued its own cashier's check in payment of a check to a third party drawn on an account of a depositor, and the depositor subsequently took action which rendered its check worthless, the bank's issuance of the cashier's check, which by definition is also an acceptance, constitutes an engagement by the bank to honor the check as presented extinguishing the right of the bank or anyone else to countermand the check. Lowe's of Sanford, Inc. v. Mid-South Bank & Trust Co., 44 N.C. App. 365, 260 S.E.2d 801 (1979), decided under Article 3 prior to its 1995 revision.

Action Against Collecting Bank. — This section operates as an exception to the final payment rule in Section 25-4-213(1) [25-4-213(a)] only to the extent that it permits the payor bank which has made final payment to seek a recovery against the collecting bank for breach of presentment warranties. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993), decided under Article 3 prior to its 1995 revision.

§ 25-3-419. Instruments signed for accommodation.

(a) If an instrument is issued for value given for the benefit of a party to the instrument, the "accommodated party", and another party to the instrument, the "accommodation party", signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation".

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to subsection (d) of this section, is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in G.S. 25-3-605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party. (1899, c. 733, ss. 28, 29, 64; Rev., ss. 2176, 2177, 2213; C.S., ss. 3008, 3009, 3045; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-419 replaces former Sections 3-415 and 3-416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co-maker or anomalous indorser. Subsection (a) distinguishes between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X's direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) of Section 3-419 takes the view stated in Comment 3 to former Section 3-415 that there need be no consideration running to the accommodation party: "The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession."

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co-maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co-maker or indorser. This is relevant to Section 3-605(h). But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

4. Subsection (b) states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3-416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in Section 3-415 and in Section 3-416. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 eliminates that confusion by stating in Section 3-419 the obligation of a person who uses words of guaranty. Portions of former Section 3-416 are preserved. Former Section 3-416(2) is reflected in Section 3-419(d) and former Section 3-416(4) is reflected in Section 3-419(c).

5. Subsection (e) restates subsection (5) of present Section 3-415. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

***Editor's Note.** — The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

An accommodation party is always a surety. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

In seeking to ascertain the intent of the parties regarding accommodation status, most courts have adopted some form of the "purpose" and "proceeds" tests. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694 (1992), cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Purpose Test. — Under the "purpose" test, the party must have signed the instrument "for the purpose of lending his name to another party to it," whether the creditor would have likely refused the primary maker but for the supposed surety's signature is an important factor to consider. In other words, the accommodating party's signature must have been necessary for the primary maker to get the loan. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Proceeds Test. — Under the "proceeds" test, the accommodating party cannot receive the primary benefits from the transaction. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Other factors to consider in determining accommodation status are whether the party took place in negotiations prior to the transaction, and the position of the party's signature on the face of the instrument itself. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

II. DECISIONS UNDER PRIOR LAW.

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Failure of Maker to Conform to Agreement. — An accommodation indorser is not relieved from liability upon the ground that the maker agreed in parol to negotiate the note at a certain bank, which he failed to do, but negotiated to the plaintiff instead, who had notice of the agreement. Parker v. McDowell, 95 N.C. 219 (1886); Parker v. Sutton, 103 N.C. 191, 9 S.E. 283 (1889).

Liability of Accommodation Indorser to Maker's Firm. — A note executed by a member of a partnership to a third party who, as surety and for the accommodation of the maker, indorses it and receives no benefit from it, cannot be the subject of an action at law against the indorser by the firm, nor in case of the death of the maker of the note can the surviving partner maintain an action on the note against the accommodation indorser unless the firm be insolvent. Patton v. Carr, 117 N.C. 176, 23 S.E. 182 (1895).

Order of Liability on Instrument. — A note, indorsed for the maker's accommodation, signed by the principal and surety, is a joint and several obligation, and the owner may sue all or either of the obligors, without joining all as defendants. Norfolk Nat'l Bank v. Griffin, 107 N.C. 173, 11 S.E. 1049 (1890); National Bank v. Carr, 121 N.C. 113, 28 S.E. 186 (1897).

Parol Evidence as to Character of Signing. — As between the payee of a negotiable note and the signers thereof, a person signing his name on the face of the note may prove by parol evidence that to the knowledge of the payee he signed the same as surety and not maker. Davis v. Alexander, 207 N.C. 417, 177 S.E. 417 (1934).

Effect of Indorsement Enlarging Liability. — "Demand, notice and protest waived, payment guaranteed by the undersigned" is an indorsement with an enlarged liability. The language makes the holder one in due course and the instrument is taken free from equities and defenses which the maker has against the payee. Richmond Guano Co. v. Walston, 191 N.C. 797, 133 S.E. 196 (1926).

Effect of Guaranteeing Prior Indorsements. — A certificate of deposit forwarded to another bank by the drawer bank must be presented in a reasonable time, and if not presented the drawer is not liable, although it stamped the certificate "Prior indorsements guaranteed." Bank of Mount Airy v. Greensboro Loan & Trust Co., 159 N.C. 85, 74 S.E. 747 (1912).

Applied in Davis v. Dillard Nat'l Bank, — F. Supp. 2d —, 2003 U.S. Dist. LEXIS 9420 (M.D.N.C. June 4, 2003).

§ 25-3-420. Conversion of instrument.

(a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument, or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.

(b) In an action under subsection (a) of this section, the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out. (1899, c. 733, s. 137; Rev., s. 2287; C.S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-420 is a modification of former Section 3-419. The first sentence of Section 3-420(a) states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3-419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter's right to possession has been denied. The second sentence of Section 3-420(a) states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, e.g. a check payable to John and Jane Doe. Under Section 3-110(d) the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John's account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3-110(d) and Comment 4 to Section 3-110. Depositary Bank does not get any greater rights under Section 4-205(1). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3-420(a) resolves the conflict by following the rule stated in *Stone & Webster Engineering Corp. v. First National Bank & Trust Co.,* 184 N.E.2d 358 (Mass. 1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against the payor bank for recredit of the drawer's account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3, under the last sentence of Section 3-420(a), the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3-301. Nor is the payee injured by the fraud. Normally the drawer of a check intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee's right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer's account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3-417(a)(1) or 4-208(a)(1). The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3-310(b)(4) provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are restricted to enforcement of the payee's rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee's possession, as for example when it is put into the payee's mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee's indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never delivered to B. Rather, Thief steals the envelope, forges B's indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A's property not B's.

2. Subsection (2) of former Section 3-419 is amended because it is not clear why the former law distinguished between the liability of the drawee and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3-419(2) what face amount meant. If a note for $10,000 is payable in a year at 10% interest, it is common to refer to $10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3, Section 3-420(b), by referring to "amount payable on the instrument," allows the full amount due under the instrument to be recovered.

The "but" clause in subsection (b) addresses the problem of conversion actions in multiple payee checks. Section 3-110(d) states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3-110(d). The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection. See *Knesz v. Central Jersey Bank & Trust Co.,* 477 A.2d 806 (N.J. 1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4-208(a)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense

provided by Section 3-420(c) is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

Legal Periodicals. — For note on recovery by payee against drawee bank on checks paid over forged endorsement, see 44 N.C.L. Rev. 1073 (1966).

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

Action Under This Section Compared to Former § 25-3-406 Action. — Where the gravaman of a plaintiff's complaint was that a defendant bank paid over funds to a person who illegally opened a joint account in her and the plaintiff's name on a fraudulent endorsement and failed to adhere to the reasonable commercial standards applicable to banking institutions, such an action was properly grounded in conversion as set forth in this section, as opposed to negligence, under former G.S. 25-3-406. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The provisions of former 25-3-419 govern allegations which draw into question a depositary bank's handling of instruments presented for deposit on allegedly fraudulent endorsements, as opposed to an ordinary negligence action. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Statute of Limitations. — If an action is one for conversion, it is clear that the applicable statute of limitations is subsection (4) of G.S. 1-52. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The "discovery rule," codified at subsection (16) of G.S. 1-52, does not apply to conversion actions. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Subdivision (16) of G.S. 1-52 was not meant to be applicable to specialized causes of action provided for in integrated statutory schemes such as found in Article 3 of Chapter 25. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The statute of limitations for conversion is clearly one "otherwise provided by statute" thereby excluded from the purview of subsection (16) of G.S. 1-52. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Under former 25-3-419 an instrument is converted when it is paid over a forged or unauthorized endorsement. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

Accrual of Cause of Action for Conversion. — The general rule appears to be that conversion actions accrue upon the conversion itself rather than upon its discovery. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Absolute Liability of Drawee. — The provision of former 25-3-419 that conversion occurs when an instrument is paid on a forged endorsement and the drawee's liability is the face amount of the instrument was intended as a rule of "absolute liability" of the drawee. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Bank's Handling of Instruments as Conversion. — The bank's acceptance of checks bearing allegedly forged endorsements for deposit in the account did not give rise to a separate action for negligence; rather, the bank's duties regarding its handling of the instruments were specifically defined under this section, which gave the nonendorsing party an action in conversion and provided a remedy. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Test of Conversion. — In an action by the nonendorsing party, the name of whose president was allegedly forged on six checks, against the bank for conversion under former 25-3-419, the critical inquiry was whether the bank dealt with the instrument in good faith and in accordance with reasonable commercial standards, not what interest the plaintiff had in the checks; likewise, in an action against the drawee, the plaintiff's interest in the proceeds of the checks was irrelevant. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Question of Fact. — Where the nonendorsing party made a prima facie showing of the bank's liability under former 25-3-419, the bank was not entitled to summary judgment on the issue of conversion; rather, the fact finder should have decided whether the instruments in question were actually paid on a forged endorsement and, if so, whether the bank used reasonable commercial standards by paying the instruments, thus limiting recovery to the amount of proceeds remaining in its hands. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Ratification Defined. — Ratification is defined as the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

Ratification as a Matter of Law. — To constitute ratification as a matter of law, the conduct must be consistent with an intent to affirm the unauthorized act and inconsistent with any other purpose. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

Ratification may be express or implied, and intent may be inferred from failure to repudiate an unauthorized act or from conduct on the part of the principal which is inconsistent with any other position than intent to adopt the act. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

Ratification requires intent to ratify plus full knowledge of all the material facts. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

When an unauthorized signature is ratified, it becomes authorized and conversion is no longer possible. American Travel Corp. v. Central Carolina Bank & Trust Co., 57 N.C. App. 437, 291 S.E.2d 892, cert. denied, 306 N.C. 555, 294 S.E.2d 369 (1982).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Payment of Check on Forged or Unauthorized Endorsement. — The majority of jurisdictions, both before and after the adoption of the NIL, allowed the holder to recover on the theory of a conversion of the check when the drawee paid a check upon a forged or unauthorized endorsement. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966).

In paying a check to an agent, a bank assumes the risk that he is without authority to endorse it. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966).

The payee of a check, as well as the drawer, has the right to expect the bank to pay the check in accordance with its tenor, and when the bank pays the check to an agent of the payee it is necessary to the bank's protection that it ascertain that the agent is authorized to receive payment for the payee, and the drawer has no right, as against the payee, to direct its payment to anyone else. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966).

Payment to Unauthorized Person Without Payee's Endorsement. — When the drawee bank takes a check without the payee's endorsement, delivers cash in the amount of the check to one unauthorized to receive its payment, and ultimately returns the check to the maker, the bank has assumed complete control over the check, dealt with it as its own, and withheld it from its rightful owner. Such dealings constitute a tortious conversion of the check, and the payee is entitled to recover its value. Prima facie, this is the face value of the paper converted. Modern Homes Constr. Co. v. Tryon Bank & Trust Co., 266 N.C. 648, 147 S.E.2d 37 (1966) (decided under the NIL).

Collection of Drafts by Creditor on Debtor. — The provisions of the NIL as to the liability of a drawee retaining or destroying a bill did not apply to drafts drawn by a creditor against his debtor and sent to a bank for collection. Branch Banking & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961).

PART 5.

DISHONOR.

§ 25-3-501. Presentment.

(a) "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to Article 4, agreement of the parties, and clearing-house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cutoff hour not earlier than 2:00 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cutoff hour. (1899, c. 733, ss. 72 to 74, 77, 78, 83, 145, 149; Rev., ss. 2221 to 2223, 2226, 2227, 2232, 2295, 2299; C.S., ss. 3053 to 3055, 3058, 3059, 3064, 3127, 3131; 1963, c. 242; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Subsection (a) defines presentment. Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) restates former Section 3-505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cut-off hour for receipt of instruments presented.

CASE NOTES

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Presentment Is Necessary to Hold Drawer. — When a draft on a third person is given in settlement of an antecedent debt, it is the duty of the holder to present it, and a failure to do so will discharge the debt. Mauney & Son v. Coit, 80 N.C. 300 (1879).

And Drawer and Indorsers Must Be Given Notice of Dishonor. — The draft having been accepted, the drawee becomes primarily liable, and in the event of dishonor, notice must be given to all those who are secondarily liable as drawer and indorsers. Denny v. Palmer, 27 N.C. 610 (1845); Brown v. Teague, 52 N.C. 573 (1860); National Bank v. Bradley, 117 N.C. 526, 23 S.E. 455 (1895).

Following the NIL it was held in Perry Co. v. Taylor Bros., 148 N.C. 362, 62 S.E. 423 (1908), that failure to give notice of dishonor discharged the indorser from further liability. Barber v. Absher, 175 N.C. 602, 96 S.E. 43 (1918).

But Failure to Present Is Matter of Defense. — If a note is payable at a particular time and place, a demand at the time and place need not be averred or proven in an action by the holder against the maker. A failure to make such demand can only be used in defense if the money was ready at the time and place. Nichols v. Pool, 47 N.C. 23 (1854).

Presentment Must Be at Place Specified. — Whenever a bill of exchange or note is made payable at a particular place, a demand at that place is sufficient, and a personal one is not necessary whether the maker lives at the same place or a different one. Sullivan v. Mitchell, 4 N.C. 93 (1814). But the maker is not bound to pay it until it is presented at the place where it is expressed to be payable. Bank of State v. President & Dirs. of Bank, 35 N.C. 75 (1851).

Or at Party's Residence or Place of Business. — A draft payable at no definite place in a city or town must be presented at the maker's residence or place of business, if he has such, at its maturity, and if he has none, then the presence of the instrument in the city is a sufficient presentation. Peoples Nat'l Bank v. Lutterloh, 95 N.C. 495 (1886).

And to Authorized Agent. — The presentment of a bill of exchange or draft must be made to the drawee or acceptor or to an authorized agent. A personal demand is not always necessary, and it is sufficient to make the demand at the residence or usual places of business of the drawee, where the presentment is for payment. It is the duty of the bank collector to be careful, not only to present the draft at the usual place of business, but, if the plaintiff was not in, to assure himself that the person to whom he presented the draft for acceptance was the authorized agent of the plaintiff. Burrus v. Life Ins. Co., 124 N.C. 9, 32 S.E. 323 (1899).

Presentment of a draft for payment at the place of its date is sufficient, no other place of presentment appearing. Wittkowski v. Smith, 84 N.C. 671 (1881).

Notice of dishonor may be waived by an indorser of a negotiable paper before or after maturity thereof by express words or by necessary implication, and when so waived, notice of dishonor need not be given. First Nat'l Bank v. Johnson, 169 N.C. 526, 86 S.E. 360 (1912). See § 25-3-511.

But Consenting to Extension Is Not Such Waiver. — It cannot be determined as a matter of law that an indorser is not entitled to notice of dishonor, as provided in the NIL, by reason of his consent to an extension of time of payment granted the principal. Davis v. Royall, 204 N.C. 147, 167 S.E. 559 (1933).

Burden Is on Holder to Show Notice of Dishonor Was Not Required. — The burden is on the holder of a note seeking to hold an indorser to whom notice of dishonor has not been given liable thereon upon the contention that notice was not required to prove that the note was given for his accommodation. Parol evidence is not admissible to show primary liability to sustain the contention that notice of dishonor was dispensed with. Busbee v. Creech, 192 N.C. 499, 135 S.E. 326 (1926).

Recovery by Forwarding Bank Limited to Loss Actually Caused by Delay. — When a bank forwards a check to another bank to be collected, and the drawee bank is negligent in notifying the forwarding bank of nonpayment, the right of the forwarding bank to recover will be determined by whether or not it would have prevented loss by notice, and it can recover such loss only as was occasioned by the delay. American Nat'l Bank v. Savannah Trust Co., 177 N.C. 254, 98 S.E. 595 (1919).

Former Rule on Protest. — Protest was not necessary to fix the drawee and indorsers of inland bills of exchange with liability, although it was necessary in the case of foreign bills. Shaw Bros. v. McNeill, 95 N.C. 535 (1886).

Lost or Destroyed Note. — The provision of the NIL that upon payment of a note it must be delivered up to the party paying it did not apply where the note had been lost or destroyed, and under the facts, there was no error in not requiring a bond for the protection of the maker where no request was made therefor. Wooten v. Bell, 196 N.C. 654, 146 S.E. 705 (1929).

§ 25-3-502. Dishonor.

(a) Dishonor of a note is governed by the following rules:

(1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(3) If the note is not payable on demand and subdivision (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under G.S. 25-4-301 or G.S. 25-4-302, or becomes accountable for the amount of the check under G.S. 25-4-302.

(2) If a draft is payable on demand and subdivision (1) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(3) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(4) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary draft occurs according to the rules stated in subdivisions (2), (3), and (4) of subsection (b), except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those subdivisions.

(d) Dishonor of an accepted draft is governed by the following rules:

(1) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(2) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(e) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under G.S. 25-3-504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(f) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored. (1899, c. 733, ss. 70, 79 to 82, 83, 89, 109 to 116, 118, 129, 130, 143, 144, 147 to 153, 158, 159, 186; Rev., ss. 2219, 2228 to 2232, 2239, 2259 to 2266, 2268, 2279, 2280, 2293, 2294, 2297 to 2303, 2309, 2336; C.S., ss. 3051, 3060 to 3064, 3071, 3091 to 3098, 3100, 3111, 3112, 3125, 3126, 3129 to 3135, 3140, 3141, 3168; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-415 provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3-414, the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3-414(d). Part 5 tells when an instrument is dishonored (Section 3-502) and what it means to give notice of dishonor (Section 3-503). Often dishonor does not occur until presentment (Section 3-501), and frequently presentment and notice of dishonor are excused (Section 3-504).

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3-502(1)(a)) unless the holder made presentment to the maker on the exact day the note was due (former Section 3-503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3-508(2)). These provisions are omitted from Revised Article 3 as inconsistent with practice which seldom involves face-to-face dealings.

3. Subsection (a) applies to notes. Subsection (a)(1) applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) applies to all other notes. If the note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. When a check is presented for payment through the check-collection system, the drawee bank normally makes settlement for the amount of the check to the presenting bank. Under Section 4-301 the drawee bank may recover this settlement if it returns the check within its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1). If the drawee bank does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check. Section 4-215. Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline. In some cases the drawee bank might not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank becomes "accountable" for the amount of the check, i.e., it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank is accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor within the midnight deadline. In all cases in which the drawee bank becomes accountable, the check has not been paid and, under Section 3-502(b)(1), the check is dishonored. The fact that the bank is obliged to pay the check does not mean that the check has been paid. When a check is presented for payment, the person presenting the check is entitled to payment not just the obligation of the drawee to pay. Until that payment is made, the check is dishonored. To say that the drawee bank is obliged to pay the check necessarily means that the check has not been paid. If the check is eventually paid, the drawee bank no longer is accountable.

Subsection (b)(2) applies to demand drafts other than those governed by subsection (b)(1). It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) and (4) applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3-501(1)(a).

5. Subsection (c) gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5-112 in cases in which a letter of credit is involved.

6. Subsection (d) governs accepted drafts. If the acceptor's obligation is to pay on demand the rule, stated in subsection (d)(1), is the same as for that of a demand note stated in subsection (a)(1). If the acceptor's obligation is to pay at a definite time the rule, stated in subsection (d)(2), is the same as that of a time note payable at a bank stated in subsection (b)(2).

7. Subsection (e) is a limitation on subsection (a)(1) and (2), subsection (b), subsection (c), and subsection (d). Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3-504, dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) and (4) if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f), the late acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

CASE NOTES

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Presentment To Be Made in Reasonable Time. — A drawer of a bill, having funds in the hands of the drawee, has a right to have the bill presented for payment, and he cannot be charged unless the bill was presented in a reasonable time, although he knew at the time of drawing the bill that the drawee was insolvent. Long v. Stephenson, 72 N.C. 569 (1875); Cedar Falls Co. v. Wallace, 83 N.C. 225 (1880).

A "check" is a bill of exchange drawn on a bank, payable on demand, and instruments payable on demand may be presented within a reasonable time after their issue. Philadelphia Life Ins. Co. v. Hayworth, 296 F. 339 (4th Cir. 1924).

The holder of a check upon a bank located in the town of his residence may present it for payment on the day after the same is drawn, and his omission to present it sooner is no defense to the drawee bank, unless he had information of its precarious condition. First Nat'l Bank v. Alexander, 84 N.C. 30 (1881).

Under the law merchant where a negotiable paper was assigned, the assignee was bound to apply for payment within a reasonable time. Plummer v. Christmas, 1 N.C. 145 (1799).

"Reasonable Time" Is Dependent Upon Circumstances. — What constitutes reasonable time will vary under the facts and circumstances of different cases. Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906).

Though it may be inconvenient to have several different rules applicable to different classes of persons, it is more so to have one applied to all, which is wholly unsuited to the habits, transactions, and experience of the greater number. It is impossible to lay down a rule in the abstract which is equally just in its bearing on all persons to be affected by it; it must depend upon the circumstances of the case, and must be determined by the jury, under the directions of the court. Raines v. Grantham, 205 N.C. 340, 171 S.E. 360 (1933), citing Brittain v. Johnson, 12 N.C. 293 (1827).

A check is only conditional payment, but the payee must exercise due diligence in presenting it for payment, and where his failure to exercise such diligence causes loss he must suffer it, due diligence being determined in accordance with the facts and circumstances of each particular case. Henderson Chevrolet Co. v. Ingle, 202 N.C. 158, 162 S.E. 219 (1932).

Facts to Be Considered. — In determining what is a reasonable time for the presentment of a check for payment, regard must be had to the nature of the instrument, the customs and usages of trade in regard to such instrument, and the facts of the particular case. Raines v. Grantham, 205 N.C. 340, 171 S.E. 360 (1933).

Time Held Unreasonable. — Where the parties all resided in the same village, four months was an unreasonable time in making a demand of the maker of a note and giving notice of nonpayment to the indorser. Yancey v. Little-john, 9 N.C. 525 (1823).

Postdated Check. — Instruments payable on demand may be presented within a reasonable time after their issue. In this respect there is no difference between a postdated check and any other. In either case it should be presented within a reasonable time after its issue, but the only effect of a failure to present it within such time is to discharge the drawer from liability to the extent of the loss caused by the delay. Philadelphia Life Ins. Co. v. Hayworth, 296 F. 339 (4th Cir. 1924).

A postdated check, like any other check, need not be presented on the day of its date, but may be presented within a reasonable time thereafter, and the fact that the drawee had money on deposit to meet it on that date, but did not have it when the check was presented, is not equivalent to a "tender of payment." Philadelphia Life Ins. Co. v. Hayworth, 296 F. 339 (4th Cir. 1924).

§ 25-3-503. Notice of dishonor.

(a) The obligation of an indorser stated in G.S. 25-3-415(a) and the obligation of a drawer stated in G.S. 25-3-414(d) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under G.S. 25-3-504(b).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to G.S. 25-3-504(c), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within 30 days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs. (1899, c. 733, ss. 70, 89 to 108, 118, 129, 143, 144, 150 to 153, 158, 186; Rev., ss. 2219, 2239 to 2258, 2268, 2279, 2293, 2294, 2300 to 2303, 2308, 2336; C.S., ss. 3051, 3071 to 3090, 3100, 3111, 3125, 3126, 3132 to 3135, 3140, 3168; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3-414. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3-414(b)) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b), which states how notice of dishonor is given, is based on former Section 3-508(3).

2. Subsection (c) replaces former Section 3-508(2). It differs from that section in that it provides a 30-day period for a person other than a collecting bank to give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3-504(c).

CASE NOTES

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Diligent Attempt to Notify Is Necessary. — A holder of a dishonored bill must give notice to all indorsers, or make a diligent attempt to give this notice if he does not know where the indorser resides. Runyon v. Montfort, 44 N.C. 371 (1853).

Former Rule as to Time for Notice. — A reasonable notice was one which was sent by the first post after the day of dishonor, and when there was a daily mail, this necessarily meant the next day, if the next day's mail did not leave before business hours. Hubbard v. Troy, 24 N.C. 134 (1841).

No Particular Form Is Required. — The notice required by law to be given to an indorser is good if it is sufficient to put the indorser on inquiry; no particular form is required, and any person through whose hands a bill or note has passed may give notice to the drawer or his prior indorser of the dishonor of the bill, although the bill or note may not have been taken up by him at that time. President of Bank v. Seawell, 9 N.C. 560 (1823).

Verbal notice is good if it is sufficient to put indorsers upon inquiry. President of Bank v. Seawell, 9 N.C. 560 (1823).

Notice sent to the place where the bill was drawn is not sufficient. Denny v. Palmer, 27 N.C. 610 (1845).

Requirement of Sending to Nearest Post Office. — The rule that notice to a distant indorser should be sent to the post office nearest to his residence was founded on the presumption that the information would most speedily be given in such way; but the rule is subject to modification, and the true inquiry is, was the notice directed to that post office which was most likely to impart to the indorser the earliest intelligence, though it may not be the nearest; if it was, it is sufficient. President of Bank v. Lane, 10 N.C. 453 (1825).

The burden is on the holder to show that notice of nonpayment was given to the indorsers of a negotiable note, and in the absence of evidence of such notice to an indorser, or to his personal representative after his death, the holder is not entitled to recover on the indorsement. Williams v. Fowler Auto. Co., 207 N.C. 309, 176 S.E. 567 (1934).

Sufficient Proof of Notice. — It has been held that evidence that the letter containing notice was put into the post office, directed to the defendant at his place of residence, was sufficient proof of the notice to be left to the jury, and that it was unnecessary to give notice to the defendant to produce the letter before parol evidence could be admitted. Faribault v. Ely, 13 N.C. 67 (1828).

§ 25-3-504. Excused presentment and notice of dishonor.

(a) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has repudiated an obligation to pay the instrument or is in insolvency proceedings or is dead, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate. (1899, c. 733, ss. 79 to 82, 109 to 116, 130, 147, 148, 151, 159; Rev., ss. 2228 to 2231, 2259 to 2266, 2280, 2297, 2298, 2301, 2309; C.S., ss. 3060 to 3063, 3091 to 3098, 3112, 3129, 3130, 3133, 3141; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-504 is largely a restatement of former Section 3-511. Subsection (4) of former Section 3-511 is replaced by Section 3-502(f).

CASE NOTES

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Knowledge of Insolvency of Drawee Does Not Excuse Presentment and Notice. — Drawers, having funds in the hands of the drawees, had the right to expect their bill to be honored by them, and they were entitled to presentment of their bill in a reasonable time and strict notice if dishonored on the part of the plaintiff, although the drawers at the time they drew the bill may have believed the drawees were insolvent and had been so notified by them and requested not to draw on them. Cedar Falls Co. v. Wallace Bros., 83 N.C. 225 (1880).

Nor Does Belief Maker Will Not Pay Note. — Although, at the time of the indorsement of a note, the indorsers had reason to believe, and did believe, that the note would not be paid by the maker, this circumstance did not dispense with the necessity of a due notice. Denny v. Palmer, 27 N.C. 610 (1845).

But Presentment Is Unnecessary to Charge Treasurer of Corporation Without Funds. — Where the treasurer of a corporation indorses corporate note, payable at a certain bank, and at its maturity the corporation has no funds at the bank, it was not necessary that the note should have been presented to the bank for payment. Meyers Co. v. Battle, 170 N.C. 168, 86 S.E. 1034 (1915).

Delay Caused by One Liable Is Excuse. — Where an agent has incurred a personal liability on a negotiable instrument given in behalf of his principal, he may not avoid payment on the ground of delay in presenting it for payment, when the delay was at his own request and by his own conduct. Caldwell County v. George, 176 N.C. 602, 97 S.E. 507 (1918).

And Where Presentment Cannot Be Made, It Is Unnecessary. — Where the maker is a seaman, without any domicile in the State, and goes on a voyage about the time the note falls due, no demand on him is necessary in order to charge the indorser. Moore v. Coffield, 12 N.C. 247 (1827).

Waiver of Protest Waives Presentment and Notice. — In foreign bills the protest may be waived; the words, "I waive protest," or "waiving protest," or any similar words, infer that the protest is waived, and when applied to foreign bills, are universally regarded as expressly waiving presentment and notice, the protest being, according to the law merchant, the formal and necessary evidence of the dishonor of such an instrument. Shaw Bros. v. McNeill, 95 N.C. 535 (1886).

Although protest is not necessary on an inland bill, yet its waiver in such a case is construed to signify as much as when applied to foreign bills. Shaw Bros. v. McNeill, 95 N.C. 535 (1886).

As Does Advance Consent to Extension. — The authorities seem to hold that where the indorser consents in advance of maturity to extensions of the time of payment of the note, he thereby waives his right to receive notice of dishonor and presentment for payment. First Nat'l Bank v. Johnson, 169 N.C. 526, 86 S.E. 360 (1915). See also Davis v. Royal, 204 N.C. 147, 167 S.E. 559 (1933).

Or Promise to Pay After Failure to Be Notified. — A promise to pay generally, or a promise to pay a part, or a part payment made, with a full knowledge that he had been fully released from liability on the bill by the neglect of the holder to give notice, will operate as a waiver and bind the party who makes it for the payment of the whole bill. Shaw Bros. v. McNeill, 95 N.C. 535 (1886).

Where, upon the dishonor of a bill of exchange or promissory note, the indorsee has neglected to give the proper notice, the drawer or indorser of the bill or indorser of the note will still be liable if, after a knowledge of all the facts which in law would have discharged him, he promises to pay the bill or note. Moore v. Tucker, 25 N.C. 347 (1843).

But Waiver of Notice Is Insufficient If There Was No Presentment. — When one, thinking there has been a presentment for payment, makes promises that would amount to a waiver, had there been a presentment, he is not liable on the grounds of waiver of notice if there had been no presentment for payment. Lilly v. Petteway, 73 N.C. 358 (1875).

Indorser Is Bound by Waiver on Face of Instrument. — Where upon the face of a negotiable note there is an agreement to waive notice of dishonor or an extension of time, etc., one placing his name on the back thereof is deemed to be an indorser without indication of other liability therein, and is bound by the agreement expressed on the face of the instrument waiving notice, etc. Gilliam v. Walker, 189 N.C. 189, 126 S.E. 424 (1925).

An extension of time for payment of a note will not discharge an indorser when the note provides on its face that extension of time for payment is waived by all parties to the note, the indorser being a "party" to the note. Vannoy v. Stafford, 209 N.C. 748, 184 S.E. 482 (1936).

Waiver Held Not to Bind Former Partner. — Where a partner, after the dissolution of the firm, gives a draft in payment of a partnership debt, he cannot waive protest so as to bind his former copartner, especially when the latter has been a dormant member. Mauney & Son v. Coit, 80 N.C. 300 (1879).

Implied Waiver of Immediate Presentment. — Where a check was given for county bonds and the bonds could not be issued at once, and the drawer cooperated with the county to get the bond issue, there was a sufficient implied waiver of immediate presentment, and a presentment within a reasonable time after the bond issue was sufficient to bind the drawer. Caldwell County v. George, 176 N.C. 602, 97 S.E. 507 (1918).

Option to Treat Bill as Bill or Note. — Under the NIL a paper coming directly within the definition of an inland bill of exchange could be treated as a bill or note at the option of the holder, the drawer and drawee being the same person. Sherrill v. American Trust Co., 176 N.C. 591, 97 S.E. 471 (1918).

Burden of Proof on Holder. — If it is in fact an accommodation paper, then, notwithstanding the form of the paper, the drawer would be primarily liable and not entitled to notice, but the burden to show this is on the holder, and there being no evidence to that fact, the form of the paper governs and the drawer is entitled to notice. National Bank v. Bradley, 117 N.C. 526, 23 S.E. 455 (1895). See Hyde v. Tatham, 204 N.C. 160, 167 S.E. 626 (1933).

§ 25-3-505. Evidence of dishonor.

(a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) A document regular in form as provided in subsection (b) of this section which purports to be a protest.

(2) A purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor.

(3) A book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice-consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties. (1899, c. 733, ss. 153, 156, 158, 160; Rev., ss. 2303, 2306, 2308, 2310; C.S., ss. 3135, 3138, 3140, 3142; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

CASE NOTES

Editor's Note. — *The cases cited below were decided under prior statutory provisions.*

Protest of Inland Bills Was Not Necessary. — Protest of an order or inland bill was not necessary to enable the holder to recover the principal and interest. Notice in due time of nonacceptance or nonpayment was all that was required for that purpose. Hubbard v. Troy, 24 N.C. 134 (1841); Peoples Nat'l Bank v. Lutterloh, 95 N.C. 495 (1886); National Bank v. Bradley, 117 N.C. 526, 23 S.E. 455 (1895), decided under former statutory provisions.

Nor Was Protest of Note Drawn in Another State. — A promissory note made in another state need not be protested before the owner may sue an indorser, there being no evidence that this is required in the state where the note was executed. State Bank v. Carr, 130 N.C. 479, 41 S.E. 876 (1902), decided under former statutory provisions.

Protest as Evidence Under Former Law. — By the law merchant a protest of a bill by a public notary was, in itself, evidence. And by statute such protest was prima facie evidence. Gordon v. Price, 32 N.C. 385 (1849), decided under former statutory provisions.

§ 25-3-506. Collection of processing fee for returned checks.

A person who accepts a check in payment for goods or services or his assignee may charge and collect a processing fee, not to exceed twenty-five dollars ($25.00), for a check on which payment has been refused by the payor bank because of insufficient funds or because the drawer did not have an account at that bank.

If a collection agency collects or seeks to collect on behalf of its principal a processing fee as specified in this section in addition to the sum payable of a check, the amount of such processing fee must be separately stated on the collection notice. The collection agency shall not collect or seek to collect from the drawer any sum other than the actual amount of the returned check and the specified processing fee. (1981, c. 781, s. 1; 1983, c. 529; 1987, c. 147; 1991, c. 455, s. 1; 1995, c. 232, s. 1; 1997-334, s. 1; 2000-118, s. 1.)

NORTH CAROLINA COMMENT

This section has no counterpart in Revised Article 3. The section was adapted from former G.S. 25-3-512.

Editor's Note. — Article 3 of the Uniform Commercial Code was revised in 1995, and during this revision, former section 25-3-507(1) became 25-3-502, 25-3-507(2) was omitted, 25-3-507(3) became 25-3-501(b)(3)(i), 25-3-507(4) was omitted; 25-3-508(1) became 25-3-503(b), 25-3-508(2) became 25-3-503(c), 25-3-508(3) became 25-3-503(b), 25-3-508(4), (5), (6), and (7) were omitted, and 25-3-508(8) became 25-3-503(b). These former sections should no longer appear in Chapter 25.

Legal Periodicals. — For 1997 legislative survey, see 20 Campbell L. Rev. 389.

PART 6.

Discharge and Payment.

§ 25-3-601. Discharge and effect of discharge.

(a) The obligation of a party to pay the instrument is discharged as stated in this Article or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge. (1899, c. 733, ss. 15, 16, 57, 119 to 121; Rev., ss. 2165, 2166, 2206, 2269 to 2271; C.S., ss. 2296, 2297, 3038, 3101 to 3103; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Subsection (a) replaces subsections (1) and (2) of former Section 3-601. Subsection (b) restates former Section 3-602. Notice of discharge is not treated as notice of a defense that prevents holder in due course status. Section 3-302(b). Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a canceled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

CASE NOTES

Editor's Note. — The cases cited below were decided under prior statutory law.

Act Discharging Simple Contract. — An instruction that a negotiable instrument may be discharged by an act which would discharge a simple contract for the payment of money was not error under the NIL. Hood Sys. Indus. Bank v. Dixie Oil Co., 205 N.C. 778, 172 S.E. 360 (1934), decided under former statutory provisions.

Compromise Payment by Surety. — When the liability of a surety or accommodation indorser is discharged by compromise and settlement, the maker is entitled to credit only for the amount actually paid. First & Citizens Nat'l Bank v. Hinton, 216 N.C. 159, 4 S.E.2d 332 (1939), decided under former statutory provisions.

§ 25-3-602. Payment.

(a) Subject to subsection (b) of this section, an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under G.S. 25-3-306 by another person.

(b) The obligation of a party to pay the instrument is not discharged under subsection (a) of this section if:

(1) A claim to the instrument under G.S. 25-3-306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) The person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument. (1899, c. 733, ss. 55, 88, 119, 121, 171 to 177; Rev., ss. 2204, 2238, 2269, 2271, 2321 to 2327; C.S., ss. 3036, 3070, 3101, 3103, 3153 to 3159; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) means, by reference to Section 3-306, a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) is added to conform to Section 3-411. Section 3-411 is intended to discourage an obligated bank from refusing payment of a cashier's check, certified check, or dishonored teller's check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3-411. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3-602(b)(1)(ii) and Section 3-411, read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3-411(c)(iv).

CASE NOTES

Editor's Note. — *The cases cited below were decided under prior statutory law.*

Indorser Can Only Recover Amount He Actually Pays. — An indorser who pays off and discharges the note of his principal can only recover from the latter the amount actually paid by him. Pace v. Robertson, 65 N.C. 550 (1871), decided under former statutory provisions.

The note of a third person given for a prior debt will be held a satisfaction, where it was agreed by the creditor to receive it absolutely as payment, and to run the risk of its being paid. The onus of establishing that it was so received is on the debtor. But there must be a clear and special agreement that the creditor shall take the paper absolutely as payment or it will be no payment if it afterwards turns out to be of no value. North Carolina Nat'l Bank v. McKee, 63 N.C. App. 58, 303 S.E.2d 842 (1983), decided under former statutory provisions.

A receipt in full of an account does not establish an agreement on the part of the creditor to accept as absolute payment at his own risk the note of a third person for the debt. North Carolina Nat'l Bank v. McKee, 63 N.C. App. 58, 303 S.E.2d 842 (1983), decided under Article 3 prior to its 1995 revision.

§ 25-3-603. Tender of payment.

(a) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument. (1899, c. 733, ss. 70, 120; Rev., ss. 2219, 2270; C.S., ss. 3051, 3102; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-603 replaces former Section 3-604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) replaces former Section 3-604(1) and (3).

CASE NOTES

Actual Presentment Required. — Borrowers could not prevail on their theory that their obligation to the bank was satisfied because the borrowers had requested a validation or verification of the amount owed and the bank had not replied, because under North Carolina law, tender did not occur until there was a presentment of funds sufficient to extinguish the entire debt. Davis v. Dillard Nat'l Bank, — F. Supp. 2d —, 2003 U.S. Dist. LEXIS 9420 (M.D.N.C. June 4, 2003).

§ 25-3-604. Discharge by cancellation or renunciation.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(b) Cancellation or striking out of an endorsement pursuant to subsection (a) of this section does not affect the status and rights of a party derived from the indorsement. (1899, c. 733, ss. 48, 119, 120, 122, 123; Rev., ss. 2197, 2269, 2270, 2272, 2273; C.S., ss. 3029, 3101, 3102, 3104, 3105; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

Section 3-604 replaces former Section 3-605.

CASE NOTES

Release Must Be Written. — The right of an obligor to defend an action against himself on a negotiable note, under the provisions of the NIL, could be done by virtue thereof only as therein expressed when the release was in writing, and could not be shown when resting only by parol. Manly v. Beam, 190 N.C. 659, 130 S.E. 633 (1925), decided under former statutory provisions.

Unless Instrument is Surrendered. — No writing is necessary if the instrument is delivered to the person primarily liable thereon. Hood Sys. Indus. Bank v. Dixie Oil Co., 205 N.C. 778, 172 S.E. 360 (1934), decided under former statutory provisions.

Acceptance of Note of Another Party and Surrender of Original. — In an action on a note the maker and sureties may rely on the discharge of the note by the payee's acceptance of the note of another party in the sum due, and the payee's delivery to them of the papers on which defendants were bound, since this is an intentional cancellation by the payee, which is not required to be in writing. Hood Sys. Indus. Bank v. Dixie Oil Co., 205 N.C. 778, 172 S.E. 360 (1934), decided under former statutory provisions.

Cancellation and surrender of a promissory note due to clerical error or mistake alone does not provide the requisite intent to effectively discharge the debt represented by that note. G.E. Capital Mtg. Servs. v. Neely, 135 N.C. App. 187, 519 S.E.2d 553 (1999).

Nonbankrupt wife remained liable under G.S. 25-3-604(a) where bank did not release wife in a "signed" writing as part of the bankrupt husband's agreement to reaffirm part of defaulted note's debt so that he could keep the collateral that was titled only in his name. First Commerce Bank v. Dockery, 171 N.C. App. 297, 615 S.E.2d 314, 2005 N.C. App. LEXIS 1202 (2005).

§ 25-3-605. Discharge of indorsers and accommodation parties.

(a) In this section, the term "indorser" includes a drawer having the obligation described in G.S. 25-3-414(d).

(b) Discharge, under G.S. 25-3-604, of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(c) If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party proves that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(d) If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(e) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(f) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (e) of this section, the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(g) Under subsection (e) or (f) of this section, impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value, (iii) failure to perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or surety or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(h) An accommodation party is not discharged under subsection (c), (d), or (e) of this section unless the person entitled to enforce the instrument knows of the accommodation or has notice under G.S. 25-3-419(c) that the instrument was signed for accommodation.

(i) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral. (1899, c. 733, s. 120; Rev., s. 2270; C.S., s. 3102; 1965, c. 700, s. 1; 1995, c. 232, s. 1.)

OFFICIAL COMMENT

1. Section 3-605, which replaces former Section 3-606, can be illustrated by an example. Bank lends $10,000 to Borrower who signs a note under which Borrower is obliged to pay $10,000 to Bank on a due date stated in the note. Bank insists, however, that Accommoda-

tion Party also become liable to pay the note. Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the accommodated party. Rights and obligations of Accommodation Party in this case are stated in Section 3-419. Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower may discharge Borrower's $10,000 obligation to pay the note by paying Bank $3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section 3-605 is concerned with this kind of problem in the context of a negotiable instrument to which the principal debtor and the surety are parties. But Section 3-605 has a wider scope. It also applies to indorsers who are not accommodation parties. Unless an indorser signs without recourse, the indorser's liability under Section 3-415 (a) is that of a guarantor of payment. If Bank in our hypothetical case indorsed the note and transferred it to Second Bank, Bank has rights given to an indorser under Section 3-605 if it is Second Bank that modifies rights and obligations of Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section 3-605 is also widened by subsection (e) which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the note or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section 3-605(i) allows waiver. Thus, Section 3-605 applies to the occasional case in which the creditor did not include a waiver clause in the instrument or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) addresses the effect of discharge under Section 3-604 of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release Accommodation Party. As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes $3,000 and releases Borrower from the $10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3-419(e). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b) changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank could settle with and release Borrower without releasing Accommodation Party, but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. The reservation of rights doctrine is abolished in Section 3-605 with respect to rights on instruments.

4. Subsection (c) relates to extensions of the due date of the instrument. In most cases an extension of time to pay a note is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 surety was discharged if consent was not given unless the payee expressly reserved rights against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. *Wilmington Trust Co. v. Gesullo,* 29 U.C.C. Rep.

144 (Del. Super. Ct. 1980). Under subsection (c) an extension of time results in discharge only to the extent the surety proves that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss, subsection (c) more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

5. Former Section 3-606 applied to extensions of the due date of a note but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 did not follow general suretyship law in covering both. Under Section 3-605(d) a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the instrument proves that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

6. Subsection (e) deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b). Subsection (g) states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as maker of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if the holder released or extended the obligation of the grantee. Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section 3-605(e) does not apply because the holder has not discharged the obligation of a "party," a term defined in Section 3-103(a)(8) as "party to an instrument." The assuming grantee is not a party to the instrument.

7. Subsection (f) is illustrated by the following case. X and Y sign a note for $1,000 as co-makers. Neither is an accommodation party. X grants a security interest in X's property to secure the note. The collateral is worth more than $1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subrogation. If the security interest had been perfected, Y could have realized on the collateral to the extent of $500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is $500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section 3-419(c). In that event Y is not discharged under subsection (e), but subsection (f) applies because X and Y are jointly and severally liable on the note. Under subsection (f), Y is treated as a co-maker with a right of contribution rather than an accommodation party with a right of reimbursement. Y is discharged to the extent of $500. If Y is the principal debtor and X is the accommodation party subsection (f) doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been obliged to reimburse X for the entire $1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived.

CASE NOTES

I. Decisions under Prior Version of Article 3.
II. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

***Editor's Note.** — The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1995 revision.*

This section requires that the impairment of collateral be unjustifiable. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

Liability of Nonaccommodating Maker. — Nonaccommodating makers and co-makers, alike, are always primarily liable on the debt and only possess a right of contribution against co-makers. Sureties, on the other hand, are only secondarily liable on the debt, and retain a right of recourse on the instrument for the full amount owing if they are made to pay. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694 (1992), cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Suretyship Defenses Are Available to Accommodation Maker or Acceptor. — Suretyship defenses are not limited to parties who are "secondarily liable," but are available to any party who is in the position of a surety, having a right of recourse either on the instrument or dehors it, including an accommodation maker or acceptor known to the holder to be so. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

Holder Not Required to File Security Agreement. — There is nothing in the Code nor any case law requiring the holder to file a security agreement. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

A trust company holding a note executed by a bankrupt corporation had no duty to the endorsers to file the security agreement later executed in proper form for recordation in order to protect the collateral for the endorsers. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

And Mere Failure to File May Not Constitute Unjustified Impairment of Collateral. — Since there is no absolute duty to file a security agreement, whether the mere failure to file would constitute an unjustifiable impairment of collateral must depend upon the facts of the particular case. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

Which Is Required by U.C.C. — Even though impairment of collateral by the holder would generally discharge the surety under the N.I.L. and even though the U.C.C. may have made that defense available to an accommodation endorser, nevertheless, the Code has added a requirement. The holder must have unjustifiably impaired the collateral. First Citizens Bank & Trust Co. v. Larson, 22 N.C. App. 371, 206 S.E.2d 775, cert. denied, 286 N.C. 214, 209 S.E.2d 315 (1974).

Availability of Defense of Discharge. — The defense of discharge provided in G.S. 25-3-606 is available to all parties who occupy the position of an accommodation party and is not available to nonaccomodating makers or co-makers. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694 (1992), cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Material Alteration as Discharge of Guarantor. — As a general rule, material alteration of the contract between the principal debtor and the creditor without the guarantor's consent will operate to discharge a guarantor. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

The general rule in this State is that a material alteration of a contract between a principal debtor and creditor without the guarantor's consent will discharge the guarantor from its obligation. Kirkhart v. Saieed, 98 N.C. App. 49, 389 S.E.2d 837 (1990).

A guarantor is discharged when the debtor and lender enter into a binding agreement to extend the time for repayment on the theory that the guarantor's right to repay the debt and proceed against the debtor for repayment has been impaired by the agreement. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

If a creditor enters into a binding agreement to extend the time of payment or performance, there has been a material alteration sufficient to discharge a guarantor. However, in order to be binding, the agreement must be supported by consideration and must set a definite time for repayment. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

Subsection (1)(b) limits the defense of discharge to those who sign an instrument as an accommodation party (surety), a position which an ordinary, nonaccomodating, maker or co-maker does not occupy. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Extension of Time for Payment. — In an action upon a negotiable instrument, the defendants on its face being joint makers, the mere fact that the plaintiff had told one of the defendants, without the knowledge of the other, "that he would take up and carry the note until fall," was not an extension of payment for a "fixed and definite" period, which would operate as a release to such other from liability. Roberson v. Spain, 173 N.C. 23, 91 S.E. 361 (1917), decided under former statutory provisions.

Where the face of a note contains an agreement that the parties should remain bound notwithstanding any extension of time granted the maker, upon payment of interest by him, the indorsers remain liable although ignorant of such extensions and payments of interest by the maker, they being bound by their agreement in the note and the extension being supported by the necessary elements of certainty, mutuality and consideration. Fidelity Bank v. Hessee, 207 N.C. 71, 175 S.E. 826 (1934), decided under former statutory provisions.

TABLES OF COMPARABLE SECTIONS FOR CHAPTER 25, REVISED ARTICLE 3

Former to Present

Editor's Note. — The following table shows G.S. sections from former Chapter 25, Article 3, and their comparable, new revised Chapter 25, Article 3 numbers. Where there is no comparable new number, the term "Omitted" has been inserted.

Former Section	Present Section
25-3-101	25-3-101
25-3-102(1)(a)	25-3-105(a)
25-3-102(1)(b)	25-3-103(a)(6)
25-3-102(1)(c)	25-3-103(a)(9)
25-3-102(1)(d)	Omitted. See Comment 2 to 25-3-414.
25-3-102(1)(e)	25-3-104(b)
25-3-102(2)	25-3-103(b)
25-3-102(3)	25-3-103(c)
25-3-102(4)	25-3-103(d)
25-3-103(1)	25-3-102(a)
25-3-103(2)	25-3-102(b)
25-3-104(1)	25-3-104(a)
25-3-104(2)(a)	25-3-104(e)
25-3-104(2)(b)	25-3-104(f)
25-3-104(2)(c)	25-3-104(j)
25-3-104(2)(d)	25-3-104(e)
25-3-104(3)	Omitted.
25-3-105(1)(a)	25-3-106(a)
25-3-105(1)(b)	Omitted. See Comment 1 to 25-3-106.
25-3-105(1)(c)	Omitted. See Comment 1 to 25-3-106.
25-3-105(1)(d)	Omitted. See Comment 1 to 25-3-106.
25-3-105(1)(e)	Omitted. See Comment 1 to 25-3-106.
25-3-105(1)(f)	25-3-106(b)(ii)
25-3-105(1)(g)	25-3-106(b)(ii)
25-3-105(1)(h)	25-3-106(b)(ii)
25-3-105(2)(a)	25-3-106(a)(ii)
25-3-105(2)(b)	25-3-106(b)(ii)
25-3-106(1)	25-3-104(a)
25-3-106(2)	Omitted.
25-3-107(1)	Omitted. See Comment to 25-3-107.
25-3-107(2)	25-3-107
25-3-108	25-3-108(a)
25-3-109(1)	25-3-108(b)
25-3-109(2)	Omitted.
25-3-110(1)	25-3-109(b)
25-3-110(1)(a)	Omitted.
25-3-110(1)(b)	Omitted.
25-3-110(1)(c)	Omitted.
25-3-110(1)(d)	25-3-110(d)
25-3-110(1)(e)	25-3-110(c)(2)(i)
25-3-110(1)(f)	25-3-110(c)(2)(iv)
25-3-110(1)(g)	Omitted.
25-3-110(2)	Omitted.
25-3-110(3)	25-3-109(b)
25-3-111(a)	25-3-109(a)(1)
25-3-111(b)	25-3-109(a)(1)
25-3-111(c)	25-3-109(a)(3) and 25-3-205(b)
25-3-112(1)(a)	Omitted.
25-3-112(1)(b)	25-3-104(a)(3)(i)
25-3-112(1)(c)	25-3-104(a)(3)(i)
25-3-112(1)(d)	25-3-104(a)(3)(ii)
25-3-112(1)(e)	25-3-104(a)(3)(iii)
25-3-112(1)(f)	25-3-311
25-3-112(1)(g)	Omitted.
25-3-112(2)	Omitted.
25-3-113	Omitted.
25-3-114(1)	Omitted. See Comment to 25-3-113.
25-3-114(2)	25-3-113(a)
25-3-114(3)	Omitted. See Comment to 25-3-113.
25-3-115	25-3-115
25-3-116(a)	25-3-110(d)
25-3-116(b)	25-3-110(d)
25-3-117(a)	25-3-110(c)(2)(ii)
25-3-117(b)	25-3-110(c)(2)(i)
25-3-117(c)	Omitted.
25-3-118(a)	25-3-104(e) and 25-3-103(a)(6)
25-3-118(b)	25-3-114
25-3-118(c)	25-3-114
25-3-118(d)	25-3-112
25-3-118(e)	25-3-116(a)
25-3-118(f)	Omitted.
25-3-119	25-3-117 and 25-3-106(a) and (b)
25-3-120	25-4-105.1(a)
25-3-121	25-4-105.1(b)
25-3-122	Omitted. See Comment 1 to 25-3-118.

Former Section	Present Section
25-3-201(1)	25-3-203(b)
25-3-201(2)	25-3-204(c)
25-3-201(3)	25-3-203(c)
25-3-202(1)	25-3-201(a)
25-3-202(2)	25-3-204(a)
25-3-202(3)	25-3-203(d)
25-3-202(4)	Omitted.
25-3-203	25-3-204(d)
25-3-204(1)	25-3-205(a)
25-3-204(2)	25-3-205(b)
25-3-204(3)	25-3-205(c)
25-3-205	Omitted.
25-3-206(1)	25-3-206(a)
25-3-206(2)	25-3-206(c)(4) and (d)
25-3-206(3)	25-3-206(b), (c), and (e)
25-3-206(4)	25-3-206(d) and (e)
25-3-207(1)(a)	25-3-202(a)(i)
25-3-207(1)(b)	25-3-202(a)(ii)
25-3-207(1)(c)	25-3-202(a)(iii)
25-3-207(1)(d)	25-3-202(a)(iii)
25-3-207(2)	25-3-202(b)
25-3-208	25-3-207
25-3-301	Omitted. See Comment to 25-3-301.
25-3-302(1)	25-3-302(a)
25-3-302(2)	Omitted. See Comment 4 to 25-3-302.
25-3-302(3)(a)	25-3-302(c)(i)
25-3-302(3)(b)	25-3-302(c)(iii)
25-3-302(3)(c)	25-3-302(c)(ii)
25-3-302(4)	25-3-302(e)
25-3-303(a)	25-3-303(a)(1) and (2)
25-3-303(b)	25-3-303(a)(3)
25-3-303(c)	25-3-303(a)(4) and (5)
25-3-304(1)(a)	25-3-302(a)(1)
25-3-304(1)(b)	Omitted.
25-3-304(2)	25-3-307(b)
25-3-304(3)(a)	25-3-302(a)(2)(iii); 25-3-304(b)(1)
25-3-304(3)(b)	25-3-304(b)(3)
25-3-304(3)(c)	25-3-304(a)(1),(2) and (3)
25-3-304(4)(a)	Omitted.
25-3-304(4)(b)	Omitted.
25-3-304(4)(c)	Omitted.
25-3-304(4)(d)	Omitted.
25-3-304(4)(e)	25-3-307
25-3-304(4)(f)	25-3-304(c)
25-3-304(5)	25-3-302(b)
25-3-304(6)	Omitted.
25-3-305(1)	25-3-306
25-3-305(2)(a)	25-3-305(a)(1)(i)
25-3-305(2)(b)	25-3-305(a)(1)(ii)
25-3-305(2)(c)	25-3-305(a)(1)(iii)
25-3-305(2)(d)	25-3-305(a)(1)(iv)
25-3-305(2)(e)*	25-3-601(b)
25-3-306(a)	25-3-306
25-3-306(b)	25-3-305(a)(2)
25-3-306(c)	25-3-305(a)(2); 25-3-303(b); 25-3-105(b)
25-3-306(d)	25-3-305(c)
25-3-307(1)(a)	25-3-308(a)
25-3-307(1)(b)	25-3-308(a)
25-3-307(2)	25-3-308(b)
25-3-307(3)	25-3-308(b)
25-3-401(1)	25-3-401(a)
25-3-401(2)	25-3-401(b)
25-3-402	25-3-204(a)
25-3-403(1)	25-3-402(a)
25-3-403(2)(a)	25-3-402(b)(2)
25-3-403(2)(b)	25-3-402(b)(2)
25-3-403(3)	25-3-402(b)(1)
25-3-404(1)	25-3-403(a)
25-3-404(2)	25-3-403(a)
25-3-405(1)(a)	25-3-404(a)
25-3-405(1)(b)	25-3-404(b)(i)
25-3-405(1)(c)	25-3-405
25-3-405(2)	25-3-403(c)
25-3-406	25-3-406
25-3-407(1)(a)	25-3-407(a)(i)
25-3-407(1)(b)	25-3-407(a)(ii)
25-3-407(1)(c)	25-3-407(a)(i)
25-3-407(2)(a)	25-3-407(b)
25-3-407(2)(b)	25-3-407(b)
25-3-407(3)	25-3-407(c)
25-3-408	25-3-303(b)
25-3-409(1)	25-3-408
25-3-409(2)	Omitted. See Comment 1 to 25-3-408.
25-3-410(1)	25-3-409(a)
25-3-410(2)	25-3-409(b)
25-3-410(3)	25-3-409(c)
25-3-411(1)	25-3-409(d); 25-3-414(c); 25-3-415(d)
25-3-411(2)	25-3-409(d)
25-3-411(3)	Omitted.
25-3-412(1)	25-3-410(a)
25-3-412(2)	25-3-410(b)
25-3-412(3)	25-3-410(c)
25-3-413(1)	25-3-412; 25-3-413(a)
25-3-413(2)	25-3-414(b) and (e)
25-3-413(3)	Omitted.
25-3-414(1)	25-3-415(a) and (b)

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* **Editor's Note.**—There is no subsection in former Article 3 designated as 25-3-305(2)(e). However, the text of 3-305(2)(e) was added to the end of 25-3-305(2)(b).

Former Section	Present Section
25-3-414(2)	Omitted.
25-3-415(1)	25-3-419(a)
25-3-415(2)	25-3-419(b)
25-3-415(3)	Omitted. See See 25-3-605(h).
25-3-415(4)	25-3-419(c)
25-3-415(5)	25-3-419(e)
25-3-416(1)	Omitted.
25-3-416(2)	25-3-419(d)
25-3-416(3)	Omitted.
25-3-416(4)	25-3-419(c)
25-3-416(5)	Omitted.
25-3-416(6)	Omitted.
25-3-417(1)	25-3-417
25-3-417(2)	25-3-416
25-3-417(3)	Omitted.
25-3-417(4)	Omitted.
25-3-418	25-3-418
25-3-419(1)	25-3-420(a)
25-3-419(2)	25-3-420(b)
25-3-419(3)	25-3-420(c)
25-3-419(4)	25-3-206(c)(4) and (d)
25-3-501(1)(a)	25-3-414(b); 25-3-502(b)(3) and (4)
25-3-501(1)(b)	25-3-415(a); 25-3-502(a)(1) and (2); 25-3-502(b), (c), (d) and (e)
25-3-501(1)(c)	25-3-414(f); 25-3-415(e) 25-3-501(2)(a) 25-3-503(a)
25-3-501(2)(b)	Omitted. See Comment 2 to 25-3-414.
25-3-501(3)	Omitted. See Comment to 25-3-505.
25-3-501(4)	Omitted.
25-3-502(1)(a)	25-3-415(e)
25-3-502(1)(b)	25-3-414(f)
25-3-502(2)	Omitted. See Comment to 25-3-505.
25-3-503	Omitted. See Comment to 25-3-502.
25-3-504(1)	25-3-501(a)
25-3-504(2)(a)	25-3-501(b)(1)
25-3-504(2)(b)	25-3-501(b)(1)
25-3-504(2)(c)	25-3-501(b)(1); 25-3-111
25-3-504(3)(a)	25-3-501(b)(1)
25-3-504(3)(b)	Omitted.
25-3-504(4)	25-3-501(b)(1)
25-3-504(5)	Omitted.
25-3-505(1)(a)	25-3-501(b)(2)(i)
25-3-505(1)(b)	25-3-501(b)(2)(ii)
25-3-505(1)(c)	Omitted.
25-3-505(1)(d)	25-3-501(b)(2)(iii)
25-3-505(2)	Omitted.
25-3-506(1)	Omitted.
25-3-506(2)	Omitted.
25-3-507(1)	25-3-502
25-3-507(2)	Omitted.
25-3-507(3)	25-3-501(b)(3)(i)
25-3-507(4)	Omitted.
25-3-508(1)	25-3-503(b)
25-3-508(2)	25-3-503(c)
25-3-508(3)	25-3-503(b)
25-3-508(4)	Omitted.
25-3-508(5)	Omitted.
25-3-508(6)	Omitted.
25-3-508(7)	Omitted.
25-3-508(8)	25-3-503(b)
25-3-509(1)	25-3-505(b)
25-3-509(2)	25-3-505(b)
25-3-509(3)	25-3-505(b)
25-3-509(4)	Omitted.
25-3-509(5)	Omitted.
25-3-510(a)	25-3-505(a)(1)
25-3-510(b)	25-3-505(a)(2)
25-3-510(c)	25-3-505(a)(3)
25-3-511(1)	Omitted.
25-3-511(2)(a)	25-3-504(a)(iv)
25-3-511(2)(b)	25-3-504(a)(ii), (iv), and (v); 25-3-504(b)
25-3-511(2)(c)	25-3-504(a)(i)
25-3-511(3)(a)	25-3-504(a)(ii)
25-3-511(3)(b)	25-3-504(a)(ii)
25-3-511(4)	25-3-502(f)
25-3-511(5)	Omitted.
25-3-511(6)	Omitted.
25-3-512	25-3-506
25-3-601(1)	25-3-601(a)
25-3-601(2)	25-3-601(a)
25-3-601(3)	Omitted.
25-3-602	25-3-601(b)
25-3-603(1)	25-3-602(a) and (b)
25-3-603(1)(a)	25-3-602(b)(2)
25-3-603(1)(b)	Omitted. See See 25-3-206(c)(3).
25-3-603(2)	Omitted.
25-3-604(1)	25-3-603(c)
25-3-604(2)	25-3-603(b)
25-3-604(3)	25-3-603(c)
25-3-605(1)(a)	25-3-604(a)(i)
25-3-605(1)(b)	25-3-604(a)(ii)
25-3-605(2)	25-3-604(b)
25-3-606(1)(a)	25-3-605(b) and (c)
25-3-606(1)(b)	25-3-605(e)
25-3-606(2)	Omitted.
25-3-701(1)	Omitted.
25-3-701(2)	Omitted.
25-3-701(3)	Omitted.
25-3-801(1)	Omitted.
25-3-801(2)	Omitted.
25-3-801(3)	Omitted.
25-3-801(4)	Omitted.
25-3-802(1)(a)	25-3-310(a) and (c)
25-3-802(1)(b)	25-3-310(b) and (c)
25-3-802(2)	Omitted.
25-3-803	25-3-119
25-3-804	25-3-309

Former Section	Present Section
25-3-805	Omitted. See Comment 2 to 25-3-104.

ARTICLE 4.

Bank Deposits and Collections.

NORTH CAROLINA COMMENT

This article is based upon the 1990 conforming and miscellaneous amendments to Article 4 of the Uniform Commercial Code (hereinafter "the 1990 Amendments").

Two types of comments appear. Under the designation "Official Comment" are the Official Comments of the National Conference of Commissioners on Uniform State Laws. Under the designation "North Carolina Comment" are comments designed to note North Carolina deviations from the 1990 Amendments. Therefore, only sections that deviate from the 1990 Amendments have a North Carolina Comment.

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PART 1.

GENERAL PROVISIONS AND DEFINITIONS.

§ 25-4-101. Short title.

This Article may be cited as Uniform Commercial Code — Bank Deposits and Collections. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years. This Article meets that need.

2. In 1950 at the time Article 4 was drafted, 6.7 billion checks were written annually. By the time of the 1990 revision of Article 4 annual volume was estimated by the American Bankers Association to be about 50 billion checks. The banking system could not have coped with this increase in check volume had it not developed in the late 1950s and early 1960s an automated system for check collection based on encoding checks with machine-readable information by Magnetic Ink Character Recognition (MICR). An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. An additional goal of the 1990 revision of Article 4 is to remove any statutory barriers in the Article to the ultimate adoption of programs allowing the presentment of checks to payor banks by electronic transmission of information captured from the MICR line on the checks. The potential of these programs for saving the time and expense of transporting the huge volume of checks from depositary to payor banks is evident.

3. Article 4 defines rights between parties with respect to bank deposits and collections. It is not a regulatory statute. It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions in Article 4 are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. This may raise consumer problems which enacting jurisdictions may wish to address in individual legislation. For example, with respect to Section 4-401(c), jurisdictions

may wish to examine their unfair and deceptive practices laws to determine whether they are adequate to protect drawers who postdate checks from unscrupulous practices that may arise on the part of persons who induce drawers to issue postdated checks in the erroneous belief that the checks will not be immediately payable. Another example arises from the fact that under various truncation plans customers will no longer receive their cancelled checks and will no longer have the cancelled check to prove payment. Individual legislation might provide that a copy of a bank statement along with a copy of the check is prima facie evidence of payment.

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For survey of 1982 commercial law, see 61 N.C.L. Rev. 1018 (1983).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Applied in First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

§ 25-4-102. Applicability.

(a) To the extent that items within this Article are also within Articles 3 and 8, they are subject to those Articles. If there is conflict, this Article governs Article 3, but Article 8 governs this Article.

(b) The liability of a bank for action or nonaction with respect to an item handled by it for purposes of presentment, payment, or collection is governed by the law of the place where the bank is located. In the case of action or nonaction by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The rules of Article 3 governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See Section 3-102(b).

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see Sections 8-304 and 8-306) may conflict with provisions of this Article (Sections 4-205, 4-207, and 4-208 [25-4-207.1]). In the case of conflict, Article 8 governs.

Section 4-210 [25-4-208] deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. Sections 4-301 and 4-302 are consistent with Section 5-112. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See Section 4-104(a)(9).

In *Clearfield Trust Co. v. United States,* 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In *United States v. Kimbell Foods, Inc.,* 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the *Kimbell* test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In *Kimbell* the Court adopted the priorities rules of Article 9.

In addition, applicable federal law may supersede provisions of this Article. One federal law that does so is the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., and its implementing Regulation CC, 12 CFR Pt. 229. In some instances this law is alluded to in the statute, e.g., Section 4-215(e) and (f) [25-4-213(e) and (f)]. In other instances, although not referred to in this Article, the provisions of the EFAA and Regulation CC control with respect to checks. For example, except between the depositary bank and its customer, all settlements are final and not provisional (Regulation CC, Section 229.36(d)), and the midnight deadline may be extended (Regulation CC, Section 229.30(c)). The Comments to this Article suggest in most instances the relevant Regulation CC provisions.

2. Subsection (b) is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or non-action with respect to any item handled by it for purposes of presentment, payment, or collection" is intended to make the conflicts rule of subsection (b) apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of *Weissman v. Banque de Bruxelles,* 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see Section 4-202(c)), and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of *St. Nicholas Bank of New York v. State Nat. Bank,* 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see Sections 4-215(a) [25-4-213(a)], 4-301, 4-302, 4-303) as well as action or non-action of a collecting bank (Sections 4-201 through 4-216 [25-4-214]); to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (Section 4-216 [25-4-214]); to action or non-action of a bank with respect to an item under the rule of Part 4 of Article 4.

d. In a case in which subsection (b) makes this Article applicable, Section 4-103(a) leaves open the possibility of an agreement with respect to applicable law. This freedom of agreement follows the general policy of Section 1-105.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This recognizes that some items may be controlled in part by articles 3, 4, and 8. In the event of any conflict article 4 governs article 3; but article 8 governs article 4.

Because negotiable instruments constitute the bulk of bank collections, there will be much overlap between articles 3 and 4. However, this article is not limited to the collection of "negotiable instruments."

Subsection (2) [now (b)]: This states a conflict of laws rule that the liability of a bank will be determined by the law of its situs. Thus, a bank need operate under only one law.

See GS 25-4-103 for variation by agreement.

See GS 25-4-104 which states: "'Item' means any instrument for the payment of money even though it is not negotiable but does not include money."

Because article 4 is not limited to negotiable instruments, it greatly expands the area of banking transactions that will be covered by more easily ascertainable rules. In the past nearly all statutes in North Carolina governing the collection process have applied only to negotiable instruments.

Legal Periodicals. — For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

CASE NOTES

Applied in Fidelity & Deposit Co. v. Bank of Bladenboro, 472 F. Supp. 885 (E.D.N.C. 1978).

Cited in Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

§ 25-4-103. Variation by agreement; measure of damages; action constituting ordinary care.

(a) The effect of the provisions of this Article may be varied by agreement, but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

(b) Federal reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements under subsection (a) of this section, whether or not specifically assented to by all parties interested in items handled.

(c) Action or nonaction approved by this Article or pursuant to federal reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or nonaction consistent with clearing-house rules and the like or with a general banking usage not disapproved by this Article, is prima facie the exercise of ordinary care.

(d) The specification or approval of certain procedures by this Article is not disapproval of other procedures that may be reasonable under the circumstances.

(e) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith, it includes any other damages the party suffered as a proximate consequence. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Section 1-102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4-103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of the effect of provisions of the Article by agreement.

2. Subsection (a) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for the lack or failure, but this subsection like Section 1-102(3) approves the practice of parties determining by agreement the standards by which the responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1-201(3). The agreement may be direct, as between the owner and the depositary bank; or indirect, as in the case in which the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement." See Section 1-201(3). *First Nat. Bank of Denver v. Federal Reserve Bank,* 6 F.2d 339 (8th Cir. 1925) (deposit slip); *Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co.,* 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); *Semingson v. Stock Yards Nat. Bank,* 162 Minn. 424, 203 N.W. 412 (1925) (passbook); *Farmers State Bank v. Union Nat. Bank,* 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (a) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. Since it is recognized that banks handle a great number of items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all nonbank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items. In total, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in *Federal Reserve Bank of Richmond v. Malloy,* 264 U.S. 160, at 167, 44 S.Ct. 296, at 298, 68 L.Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (b) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating circulars, clearing-house rules, and the like, have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations. Various sections of the Federal Reserve Act (12 U.S.C. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and Section 13 (12 U.S.C. § 342) authorizes each Federal Reserve bank to receive deposits from nonmember banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Subpart A — Collection of Checks and Other Items). Under the supremacy clause of the Constitution, federal regulations prevail over state statutes. Moreover, the Expedited Funds Availability Act, 12 U.S.C. Section 4007(b) provides that the Act and Regulation CC, 12 CFR 229, supersede "any provision of the law of any State, including the Uniform Commercial Code as in effect in such State, which is inconsistent with this chapter or such regulations." See Comment 1 to Section 4-102.

Federal Reserve operating circulars. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate operating circulars covering operating details. Regulation J, for example, provides that "Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its handling of items and other matters deemed appropriate by the Reserve Bank." This Article recognizes that "operating circulars" issued pursuant to the regulations and concerned with operating details as appropriate may, within their proper sphere, vary the effect of the Article.

Clearing-House Rules. Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized these rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (b) in recognizing clearing-house rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing-house rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating circulars" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing-house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other agencies or associations of this kind may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open possibilities for future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (b).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in Section 3-103(a)(4). The term "ordinary care" is defined in Section 3-103(a)(7). These definitions are made to apply to Article 4 by Section 4-104(c). Section 4-202 states respects in which collecting banks must use ordinary care. Subsection (c) of Section 4-103 provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating circulars constitutes the exercise of ordinary care. Federal Reserve regulations and operating circulars constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (c) further provides that, absent special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearing-house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1-205(2). In a case in which the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of Section 1-205(3), action or non-action consistent with clearing-house rules or the like or with banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and although there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is prima facie only, thus conferring on the courts the ultimate power to determine ordinary care in any case in which it should appear desirable to do so. The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair as used by the particular bank.

5. Subsection (d), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If this procedure is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (e) sets forth a rule for determining the measure of damages for failure to exercise ordinary care which, under subsection (a), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. The term "bad faith" is not defined; the connotation is the absence of good faith (Section 3-103). When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, if bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (e) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

Subsection (e) is modified for clarity by inserting a comma immediately after the word "faith" in the second sentence of the subsection.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

A bank may not disclaim its responsibility for its own lack of good faith or failure to exercise ordinary care; but generally other express or implied agreements will be recognized.

Flexibility is permitted by subsection (4) [now (d)] which recognizes that procedures not specifically approved by article 4 may nevertheless be reasonable.

Subsection (5) [now (e)] states the usual rule on the measure of damages for (1) mere negligence and (2) for bad faith action or inaction.

CASE NOTES

Bank Cannot Disclaim Failure To Use Ordinary Care. — Where the Chapter 7 trustee alleged a check kiting scheme in a breach of contract claim against the debtor's bank, whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under G.S. 25-4-103, a bank cannot absolve itself of liability for its own failure to exercise ordinary care or its lack of good faith and thus, the bank was denied summary judgment on the breach of contract claim. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

Cited in Fidelity & Deposit Co. v. Bank of Bladenboro, 596 F.2d 632 (4th Cir. 1979).

§ 25-4-104. Definitions and index of definitions.

(a) In this Article, unless the context otherwise requires:

(1) "Account" means any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit.

(2) "Afternoon" means the period of a day between noon and midnight.

(3) "Banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions.

(4) "Clearing house" means an association of banks or other payors regularly clearing items.

(5) "Customer" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank.

(6) "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities (G.S. 25-8-102) or instructions for uncertificated securities (G.S. 25-8-102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft.

(7) "Draft" means a draft as defined in G.S. 25-3-104 or an item, other than an instrument, that is an order.

(8) "Drawee" means a person ordered in a draft to make payment.

(9) "Item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip.

(10) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later.

(11) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit, by remittance, or otherwise as agreed. A settlement may be either provisional or final.

(12) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over, or that it ceases or refuses to make payments in the ordinary course of business.

(b) Other definitions applying to this Article and the sections in which they appear are:

"Agreement for electronic presentment"	G.S. 25-4-110.
"Bank"	G.S. 25-4-105.
"Collecting bank"	G.S. 25-4-105.
"Depositary bank"	G.S. 25-4-105.
"Intermediary bank"	G.S. 25-4-105.
"Payor bank"	G.S. 25-4-105.
"Presenting bank"	G.S. 25-4-105.
"Presentment notice"	G.S. 25-4-110.

(c) "Control" as provided in G.S. 25-7-106 and the following definitions in other Articles apply to this Article:

"Acceptance"	G.S. 25-3-409.
"Alteration"	G.S. 25-3-407.
"Cashier's check"	G.S. 25-3-104.
"Certificate of deposit"	G.S. 25-3-104.
"Certified check"	G.S. 25-3-409.
"Check"	G.S. 25-3-104.
"Draft"	G.S. 25-3-104.
"Holder in due course"	G.S. 25-3-302.
"Instrument"	G.S. 25-3-104.
"Notice of dishonor"	G.S. 25-3-503.
"Order"	G.S. 25-3-103.
"Ordinary care"	G.S. 25-3-103.
"Person entitled to enforce"	G.S. 25-3-301.
"Presentment"	G.S. 25-3-501.
"Promise"	G.S. 25-3-103.
"Prove"	G.S. 25-3-103.
"Teller's check"	G.S. 25-3-104.
"Unauthorized signature"	G.S. 25-3-403.

(d) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1965, c. 700, s. 1; 1995, c. 232, s. 2; 1997-181, s. 19; 2006-112, ss. 14, 41.)

OFFICIAL COMMENT (1991 ED.)

1. Paragraph (a)(1): "Account" is defined to include both asset accounts in which a customer has deposited money and accounts from which a customer may draw on a line of credit. The limiting factor is that the account must be in a bank.

2. Paragraph (a)(3): "Banking day." Under this definition that part of a business day when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

3. Paragraph (a)(4): "Clearing house." Occasionally express companies, governmental agencies and other nonbanks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

4. Paragraph (a)(5): "Customer." It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical nonbank customer or depositor.

5. Paragraph (a)(6): "Documentary draft" applies even though the documents do not accompany the draft but are to be received by the drawee or other payor before acceptance or payment of the draft.

6. Paragraph (a)(7): "Draft" is defined in Section 3-104 as a form of instrument. Since Article 4 applies to items that may not fall within the definition of instrument, the term is defined here to include an item that is a written order to pay money, even though the item may not qualify as an instrument. The term "order" is defined in Section 3-103.

7. Paragraph (a)(8): "Drawee" is defined in Section 3-103 in terms of an Article 3 draft which is a form of instrument. Here "drawee" is defined in terms of an Article 4 draft which includes items that may not be instruments.

8. Paragraph (a)(9): "Item" is defined broadly to include an instrument, as defined in Section 3-104, as well as promises or orders that may not be within the definition of "instrument." The terms "promise" and "order" are defined in Section 3-103. A promise is a written undertaking to pay money. An order is a written instruction to pay money. But see Section 4-110(c). Since bonds and other investment securities under Article 8 may be within the term "instru-

ment" or "promise," they are items and when handled by banks for collection are subject to this Article. See Comment 1 to Section 4-102. The functional limitation on the meaning of this term is the willingness of the banking system to handle the instrument, undertaking or instruction for collection or payment.

9. Paragraph (a)(10): "Midnight deadline." The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible terminating points, such as the close of the banking day or business day.

10. Paragraph (a)(11): The term "settle" has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating circulars, in clearing-house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop-payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment."

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, if qualified by the adjective "provisional" its tentative nature is intended, and if qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

11. Paragraph (a)(12): "Suspends payments." This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

Subdivision (a)(11) is modified for clarity by substituting the phrase "in a charge or credit, by remittance" for the phrase "in a charge or credit or by remittance."

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

The definitions given make no major changes in North Carolina law; however, a familiarity with the definition is necessary to a reasonable comprehension of the UCC.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 14 and 41, effective October 1, 2006, in subsection (c), deleted "'Good faith' G.S. 25-3-103." and added "'Control' as provided in G.S. 25-7-106 and" at the beginning of the introductory paragraph.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

A savings account withdrawal slip is an instrument and an item within the meaning of subsection (1)(g) (now (a)(9)) of this section. Burnette v. First Citizens Bank & Trust Co., 48 N.C. App. 585, 269 S.E.2d 317 (1980).

Instruments Held Drafts. — Instruments which consisted of three parts, with the top part being a bank "draft," the second part being a record copy of the draft, and the third part being an envelope into which titles of vehicles purchased with drafts were to be inserted and mailed, were not "checks" under this section, but were "drafts." Fidelity & Deposit Co. v. Bank of Bladenboro, 472 F. Supp. 885 (E.D.N.C. 1978), aff'd, 596 F.2d 632 (4th Cir. 1979).

Applied in North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978).

Cited in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-105. "Bank"; "depositary bank"; "intermediary bank"; "collecting bank"; "payor bank"; "presenting bank".

In this Article:

(1) "Bank" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company.

(2) "Depositary bank" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter.

(3) "Payor bank" means a bank that is the drawee of a draft.

(4) "Intermediary bank" means a bank to which an item is transferred in course of collection except the depositary or payor bank.

(5) "Collecting bank" means a bank handling an item for collection except the payor bank.

(6) "Presenting bank" means a bank presenting an item except a payor bank. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The definitions in general exclude a bank to which an item is issued, as this bank does not take by transfer except in the particular case covered in which the item is issued to a payee for collection, as in the case in which a corporation is transferring balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable if a check is given in payment of a mortgage. This bank has the status of a payee under Article 3 on Negotiable Instruments and not that of a collecting bank.

2. Paragraph (1): "Bank" is defined in Section 1-201(4) as meaning "any person engaged in the business of banking." The definition in paragraph (1) makes clear that "bank" includes savings banks, savings and loan associations, credit unions and trust companies, in addition to the commercial banks commonly denoted by use of the term "bank."

3. Paragraph (2): A bank that takes an "on us" item for collection, for application to a customer's loan, or first handles the item for other reasons is a depositary bank even though it is also the payor bank. However, if the holder presents the item for immediate payment over the counter, the payor bank is not a depositary bank.

4. Paragraph (3): The definition of "payor bank" is clarified by use of the term "drawee."

That term is defined in Section 4-104 as meaning "a person ordered in a draft to make payment." An "order" is defined in Section 3-103 as meaning "a written instruction to pay money .... An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." The definition of order is incorporated into Article 4 by Section 4-104(c). Thus a payor bank is one instructed to pay in the item. A bank does not become a payor bank by being merely authorized to pay or by being given an instruction to pay not contained in the item.

5. Paragraph (4): The term "intermediary bank" includes the last bank in the collection process if the drawee is not a bank. Usually the last bank is also a presenting bank.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

The definitions in general exclude a bank *to which* an item is issued.

The term "payor bank" includes a drawee bank. Whether "payor bank" includes a bank "at" which an instrument is merely payable will depend on which alternative is adopted under GS 25-3-121 (instruments payable at bank) [see now GS 25-4-105.1]. Since Alternative B of GS 25-3-121 is adopted in North Carolina, a bank "at" which an instrument is payable will not be a "payor bank" because the instrument will not be an "order" on it. Such bank will be a "presenting bank" or a "collecting bank." See Official Comment 2.

Suggested possible amendment: Further study and consultation with the Permanent Editorial Board may reveal that GS 25-3-120, 25-3-121 [see now GS 25-4-105.1], 25-4-105 (b) [(3)], 25-4-204 (2) (a) and other sections of articles 3 and 4 should be amended to more clearly describe: (1) The exact nature of an instrument payable "through" or "at" a bank; and (2) the technical rights and duties of the bank in question.

Legal Periodicals. — For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

CASE NOTES

Status of Bank As "Collecting Bank" vs "Payor Bank". — Where the Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S. 25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

Applied in North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978); Fidelity & Deposit Co. v. Bank of Bladenboro, 472 F. Supp. 885 (E.D.N.C. 1978).

Cited in North Carolina Nat'l Bank v. Hammond, 298 N.C. 703, 260 S.E.2d 617 (1979); Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241 (1987).

§ 25-4-105.1. Payable through or payable at bank; collecting bank.

(a) If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(b) If an item states that it is "payable at" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(c) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank. (1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. This section replaces former Sections 3-120 and 3-121. Some items are made "payable through" a particular bank. Subsection (a) states that such language makes the bank a collecting bank and not a payor bank. An item identifying a "payable through" bank can be presented for payment to the drawee only by the "payable through" bank. The item cannot be presented to the drawee over the counter for immediate payment or by a collecting bank other than the "payable through" bank.

2. Subsection (b) retains the alternative approach of the present law. Under Alternative A a note payable at a bank is the equivalent of a draft drawn on the bank and the midnight deadline provisions of Sections 4-301 and 4-302 apply. Under Alternative B a "payable at" bank is in the same position as a "payable through" bank under subsection (a).

3. Subsection (c) rejects the view of some cases that a bank named below the name of a drawee is itself a drawee. The commercial understanding is that this bank is a collecting bank and is not accountable under Section 4-302 for holding an item beyond its deadline. The liability of the bank is governed by Sections 4-202(a) and 4-103(e).

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-106.

§ 25-4-106. Separate office of a bank.

A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at which action may be taken or to which notices or orders must be given under this Article and under Article 3. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices. The decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.

2. In many states and for many purposes a branch or separate office of the bank should be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true if branch banking is permitted throughout a state or in different towns and cities. Similarly, if there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provided simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For

example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Sections 4-207 and 4-208 [25-4-207.1] (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, in cases in which the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop-payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, the notice or order would be effective at the proper branch from the time it was or should have been received. See Section 1-201(27).

5. The bracketed language ("maintaining its own deposit ledger") in former Section 4-106 [25-4-106] is deleted. Today banks keep records on customer accounts by electronic data storage. This has led most banks with branches to centralize to some degree their record keeping. The place where records are kept has little meaning if the information is electronically stored and is instantly retrievable at all branches of the bank. Hence, the inference to be drawn from the deletion of the bracketed language is that where record keeping is done is no longer an important factor in determining whether a branch is a separate bank.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

This section is modified for clarity by substituting the phrase "determining the place at which action may be taken or to which notices or orders must be given" for the phrase "determining the place at or to which action may be taken or notices or orders must be given."

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-107.

Legal Periodicals. — For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

CASE NOTES

Intent of 1967 Amendment. — The legislature, in deleting in 1967 the provisions of this section requiring the maintenance of separate deposit ledgers, intended to lessen the requirements for a branch to attain separate bank status. This amendment is consistent with the legislature's encouragement of statewide branch banking to serve the "needs and convenience" of the public. North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978), cert. denied, 296 N.C. 410, 267 S.E.2d 656 (1979).

The application of this section is not mandatory. North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978), cert. denied, 296 N.C. 410, 267 S.E.2d 656 (1979).

A branch or separate office may be treated as a separate bank for certain purposes while maintaining the single legal entity for other reasons. North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978), cert. denied, 296 N.C. 410, 267 S.E.2d 656 (1979).

Branch Banks Entitled to Separate Status. — Branch banks, each operating through a different operations center which maintained the accounts of customers in its district separately, were entitled to separate bank status under this section in considering the issue before the court of whether the plaintiff preserved its right of charge-back against the defendant's account. North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978), cert. denied, 296 N.C. 410, 267 S.E.2d 656 (1979).

Separate Status As "Collecting Bank" vs "Payor Bank" Not Available. — Where the

Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S. 25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

Statute Provided No Guidance As to Whether Branch Banks Were Separate Entities in Attachment Proceedings. — In holding that North Carolina courts would adopt the separate entity rule, while G.S. 25-4-106 made clear that bank branches might sometimes have been considered a single entity, it provided no guidance as to whether that was the case in attachment proceedings. Sara Lee Corp. v. Gregg, — F. Supp. 2d —, 2003 U.S. Dist. LEXIS 23479 (M.D.N.C. Dec. 18, 2003).

§ 25-4-107. Time of receipt of items.

(a) For the purpose of allowing time to process items, prove balances, and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2:00 p.m. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(b) An item or deposit of money received on any day after a cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Each of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed within the time limits imposed by Article 4. Subsection (a) approves a cutoff hour of this type provided it is not earlier than 2 P.M. Subsection (b) provides that if such a cutoff hour is fixed, items received after the cutoff hour may be treated as being received at the opening of the next banking day. If the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P.M. cutoff hour does not involve a large portion of the items received but at the same time permits a bank using such a cutoff hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The provision in subsection (b) that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases in which a bank closes at twelve or one o'clock, e.g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This permits items received after the *earlier* of (a) the 2:00 P.M. "cut-off" or (b) the close of the banking day to be treated as received at the opening of the next banking day. *Example*: Banks that remain open on Friday until 6:00 P.M. and are closed on Saturday, may treat items received after 2:00 P.M. Friday as being received on the next Monday morning.

This provision is not mandatory on the banks.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-108.

§ 25-4-108. Delays.

(a) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank, and with or without the approval of any person involved, may waive, modify, or extend time limits imposed or permitted by this Chapter for a period not exceeding two additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party.

(b) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this Chapter or by instructions is excused if (i) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank, and (ii) the bank exercises such diligence as the circumstances require. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Sections 4-202(b), 4-214 [25-4-212], 4-301, and 4-302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4-103 they may be varied by agreement or by Federal Reserve regulations or operating circular, clearing-house rules, or the like. Subsection (a) permits a very limited extension of these time limits. It authorizes a collecting bank to take additional time in attempting to collect drafts drawn on nonbank payors with or without the approval of any interested party. The right of a collecting bank to waive time limits under subsection (a) does not apply to checks. The two-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

2. An extension granted under subsection (a) is without discharge of drawers or indorsers. It therefore extends the times for presentment or payment as specified in Article 3.

3. Subsection (b) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal regulations or operating circulars, clearing-house rules or the like. The latter time limits are "permitted" by the Code. For example, a payor bank that fails to make timely return of a dishonored item may be accountable for the amount of the item. Subsection (b) excuses a bank from this liability when its failure to meet its midnight deadline resulted from, for example, a computer breakdown that was beyond the control of the bank, so long as the bank exercised the degree of diligence that the circumstances required. In *Port City State Bank v. American National Bank,* 486 F.2d 196 (10th Cir. 1973), the court held that a bank exercised sufficient diligence to be excused under this subsection. If delay is sought to be excused under this subsection, the bank has the burden of proof on the issue of whether it exercised "such diligence as the circumstances require." The subsection is consistent with Regulation CC, section 229.38(e).

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

The section permits two delays to be harmless:

Subsection (1) [now (a)]: This subsection gives an extra day for timely action in securing payment. The extra day is permitted only when bank acts in good faith. Thus, it cannot be exercised when a customer instructs otherwise.

Since time may be extended "without discharge of secondary parties," this section will extend the time for presentment or payment under GS 25-3-503 and 25-3-506 [omitted from 1995 revision], because article 4 controls article 3.

Subsection (2) [now (b)]: This subsection permits even further delay to be harmless when certain emergencies cause the delay.

Though this subsection does not include a specific "without discharge of secondary parties provision" as in subsection (1) [now (a)], such excused delay will not cause a discharge of secondary parties under GS 25-3-501 and 25-3-511.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-109.

§ 25-4-109: Repealed by Session Laws 1995, c. 232, s. 2.

§ 25-4-110. Electronic presentment.

(a) "Agreement for electronic presentment" means an agreement, clearinghouse rule, or federal reserve regulation or operating circular, providing that presentment of an item may be made by transmission of an image of the item or information describing the item ("presentment notice") rather than delivery of the item itself. The agreement may provide for procedures governing retention, presentment, payment, dishonor, and other matters concerning items subject to the agreement.

(b) Presentment of an item pursuant to an agreement for presentment is made when the presentment notice is received.

(c) If presentment is made by presentment notice, a reference to "item" or "check" in this Article means the presentment notice unless the context otherwise indicates. (1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. "An agreement for electronic presentment" refers to an agreement under which presentment may be made to a payor bank by a presentment notice rather than by presentment of the item. Under imaging technology now under development, the presentment notice might be an image of the item. The electronic presentment agreement may provide that the item may be retained by a depositary bank, other collecting bank, or even a customer of the depositary bank, or it may provide that the item will follow the presentment notice. The identifying characteristic of an electronic presentment agreement is that presentment occurs when the presentment notice is received. "An agreement for electronic presentment" does not refer to the common case of retention of items by payor banks because the item itself is presented to the payor bank in these cases. Payor bank check retention is a matter of agreement between payor banks and their customers. Provisions on payor bank check retention are found in Section 4-406(b).

2. The assumptions under which the electronic presentment amendments are based are as follows: No bank will participate in an electronic presentment program without an agreement. These agreements may be either bilateral (Section 4-103(a)), under which two banks that frequently do business with each other may agree to depositary bank check retention, or multilateral (Section 4-103(b)), in which large segments of the banking industry may participate in such a program. In the latter case, federal or other uniform regulatory standards would likely supply the substance of the electronic presentment agreement, the application of which could be triggered by the use of some form of identifier on the item. Regulation CC, Section 229.36(c) authorizes truncation agreements but forbids them from extending return times or otherwise varying requirements of the part of Regulation CC governing check collection without the agreement of all parties interested in the check. For instance, an extension of return time could damage a depositary bank which must make funds available to its customers under mandatory availability schedules. The Expedited Funds Availability Act, 12 U.S.C. Section 4008(b)(2), directs the Federal Reserve Board to consider requiring that banks provide for check truncation.

3. The parties affected by an agreement for electronic presentment, with the exception of the customer, can be expected to protect themselves. For example, the payor bank can probably be expected to limit its risk of loss from drawer forgery by limiting the dollar amount of eligible items (Federal Reserve program), by reconcilement agreements (ABA Safekeeping

program), by insurance (credit union share draft program), or by other means. Because agreements will exist, only minimal amendments are needed to make clear that the UCC does not prohibit electronic presentment.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

Subsection (a) is modified for clarity by substituting the phrase "an image of the item" for the phrase "an image of an item" in the first sentence of the subsection.

§ 25-4-111. Statute of limitations.

An action to enforce an obligation, duty, or right arising under this Article must be commenced within three years after the cause of action accrues. (1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

This section conforms to the period of limitations set by Section 3-118(g) for actions for breach of warranty and to enforce other obligations, duties or rights arising under Article 3. Bracketing "cause of action" recognizes that some states use a different term, such as "claim for relief."

PART 2.

COLLECTION OF ITEMS: DEPOSITARY AND COLLECTING BANKS.

§ 25-4-201. Status of collecting bank as agent and provisional status of credits; applicability of Article; item indorsed "pay any bank".

(a) Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack or indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment, collection, or return, the relevant provisions of this Article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(b) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(1) Returned to the customer initiating collection; or

(2) Specially indorsed by a bank to a person who is not a bank. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. This section states certain basic rules of the bank collection process. One basic rule, appearing in the last sentence of subsection (a), is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for

collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (a) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (a) state a rule of agency status. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or sub-agent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, status may have importance in some residual areas not covered by specific rules. Further, since status has been considered so important in the past, to omit all reference to it might cause confusion. The status of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn." Thus questions heretofore litigated as to whether ordinary indorsements "for deposit," "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not alter the agency status. See A.L.R. references supra in Comment 1.

A contrary intent can change agency status but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provided. Legends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating circulars consistently so provide. The status is consistent with rights of charge-back (Section 4-214 [25-4-212] and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4-216 [25-4-214] and Section 13 of the ABA Code). The right of charge-back with respect to checks is limited by Regulation CC, Section 226.36(d).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although Section 4-215(a) [25-4-213(a)] provides that an item is finally paid when the payor bank takes or fails to take certain action with respect to the item, the final payment of the item may or may not result in the simultaneous final settlement for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4-215(c) [25-4-213(c)], and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until the remittance draft finally clears. See Section 4-213(c) [25-4-211(c)]. The first sentence of subsection (a) provides that the agency status of a collecting bank (whether intermediary or depositary) continues until the settlement given by it for the item is or becomes final. In the case of the series of provisional credits covered by Section 4-215(c) [25-4-213(c)], this could be simultaneously with the final payment of the item by the payor bank. In cases in which remittance drafts are used or in straight noncash collections, this would not be until the times specified in Sections 4-213(c) [25-4-211(c)] and 4-215(d) [25-4-213(d)]. With respect to checks Regulation CC Sections 229.31(c), 229.32(b), and 229.36(d) provide that all settlements between banks are final in both the forward collection and return of checks.

Under Section 4-213(a) [25-4-211(a)] settlements for items may be made by any means agreed to by the parties. Since it is impossible to contemplate all the kinds of settlements that will be utilized, no attempt is made in Article 4 to provide when settlement is final in all cases. The guiding principle is that settlements should be final when the presenting person has received usable funds. Section 4-213(c) and (d) [25-4-211 (c) and (d)] and Section 4-215(c) [25-4-213(c)] provide when final settlement occurs with respect to certain kinds of settlement, but these provisions are not intended to be exclusive.

A number of practical results flow from the rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4-214 [25-4-212]. Offsetting rights favorable to the owner are that pending such final settlement, the owner has the preference rights of Section 4-216 [25-4-214] and the direct rights of Section 4-302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank. With respect to checks, rights of the parties in insolvency are determined by Regulation CC Section 229.39 and the liability of a bank handling a check to a subsequent bank that does not receive payment because of suspension of payments by another bank is stated in Regulation CC Section 229.35(b).

5. In those cases in which some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e.g., if the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight noncash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (a) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of setoff, would not produce a valid setoff. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Because the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and thus in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or sub-agent but in Section 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. Thus Section 4-201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules so expressed.

7. Subsection (b) protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4-210 [25-4-208], in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3-207). A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4-103(e), the bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4-206 (e.g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (b) operative by indorsements such as "Pay any bank--X100." Regulation CC Section 229.35(c) states the effect of an indorsement on a check by a bank.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

The major emphasis of this section is in the last sentence of subsection (1), which states that the rules of article 4 apply regardless of whether a bank in the collection chain is an agent or an owner.

For residual areas not covered by specific rules, questions of agency or ownership status may still be important. A partial solution to these vital agency-ownership questions is found in sentences one and two of subsection (1) which in effect state:

(1) A bank is to be treated as an agent or subagent of the owner unless a contrary intent clearly appears.

(2) This agency relationship continues until settlements become final.

(3) Settlements are only provisional unless a contrary intent clearly appears.

(4) The form of indorsement or lack of indorsement does not affect agency or ownership status.

(5) Even though bank is a mere agent, it will have certain rights in the instrument (see GS 25-4-208 [25-4-207.1] on security interest and GS 25-4-209 [25-4-207.2] on bank as HDC).

Generally, this section is consistent with prevailing law and practice in the United States today; and it helps to clarify some uncertain areas of North Carolina law. See several North Carolina cases on agency problem digested in North Carolina Digest, Banks and Banking, Key Numbers 156 and 159.

Subsection (2) states the rule governing the rights of parties to an instrument containing words "pay any bank" or the like.

CASE NOTES

Right to Refuse to Allow Withdrawal Against Uncollected Funds. — Each time a depositor seeks to make a withdrawal against uncollected funds, the bank is entitled to choose whether to stand on or waive its right to refuse to allow such a withdrawal. Discount Auto Mart, Inc. v. Bank of N.C., 45 N.C. App. 543, 263 S.E.2d 41 (1980).

A bank did not waive its right to refuse to allow a depositor to make withdrawals from his account against uncollected funds by allowing him to make such withdrawals over a period of 15 months. Discount Auto Mart, Inc. v. Bank of N.C., 45 N.C. App. 543, 263 S.E.2d 41 (1980).

When a Debt Obligation Is Created. — Where the Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S.25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

§ 25-4-202. Responsibility for collection or return; when action timely.

(a) A collecting bank must exercise ordinary care in:
  (1) Presenting an item or sending it for presentment;
  (2) Sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted, as the case may be;
  (3) Settling for an item when the bank receives final settlement; and
  (4) Notifying its transferor of any loss of delay in transit within a reasonable time after discovery thereof.

(b) A collecting bank exercises ordinary care under subsection (a) of this section by taking proper action before its midnight deadline following receipt of an item, notice, or settlement. Taking proper action within a longer reasonable time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Subject to subsection (a)(1) of this section, a bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person or for loss or destruction of an item in the possession of others or in transit. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) states the basic responsibilities of a collecting bank. Of course, under Section 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (a) it must also use ordinary care in the exercise of its basic collection tasks. By Section 4-103(a) neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection (a)(1) requires ordinary care with respect both to the time and manner of presentment. (Sections 3-501 and 4-212 [25-4-210].) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4-204), and also in the selection of intermediary banks or other agents.

3. Subsection (a) describes types of basic action with respect to which a collecting bank must use ordinary care. Subsection (b) deals with the time for taking action. It first prescribes the general standard for timely action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is timely. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has taken timely action. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be timely but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is timely. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of Section 4-103, or under the special provisions regarding time of receipt of items (Section 4-108 [25-4-107]), and regarding delays (Section 4-109 [25-4-108]). This subsection (b) deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4-301 and 4-302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (c) adopts the Massachusetts rule. But since this is stated to be subject to subsection (a)(1) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them. Regulation CC Section 229.36(d) states the liability of a bank during the forward collection of checks.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

Subsection (b) is modified for clarity by substituting the phrase "longer reasonable time" for the phrase "reasonably longer time" in the second sentence of the subsection.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This simply states a bank's general duty to use ordinary care.

Since direct return procedures are used in North Carolina, the phrase relating thereto has been included in subsection (1)(b) [now (a)(2)].

Subsection (2) [now (b)]: This prescribes the general *time* for seasonable action. "Midnight deadline" is defined in GS 25-4-104 (1)(h) [now (a)(10)].

This subsection applies only to "collecting banks." Time limits for "payor banks" appear in GS 25-4-301 and 25-4-302.

Subsection (3) [now (c)]: This adopts the so-called "Massachusetts" rule of agency under which a collecting agent bank is responsible only for its own negligence and not that of subagents. This was the North Carolina rule of agency for bank collections.

CASE NOTES

Defendant bank, upon dishonor of a draft, did not have a duty to send the titles of automobiles to the bank to which plaintiffs had issued a banker's blanket bond, where the titles were "accompanying documents" and where the bank to which the plaintiffs issued the bond never established a "security interest" in those titles prior to the time the defendant bank sent them back to the drawee after they were dishonored. Fidelity & Deposit Co. v. Bank of Bladenboro, 472 F. Supp. 885 (E.D.N.C. 1978), aff'd, 596 F.2d 632 (4th Cir. 1979).

§ 25-4-203. Effect of instructions.

Subject to Article 3 concerning conversion of instruments (G.S. 25-3-420) and restrictive indorsements (G.S. 25-3-206), only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it, and a collecting bank is not liable to prior parties for any action taken pursuant to the instructions or in accordance with any agreement with its transferor. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 concerning conversion of instruments (Section 3-420) and restrictive indorsements (Section 3-206). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4-103(a). If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This section adopts a "chain of command" theory which makes it unnecessary for an intermediary or collecting bank to determine whether its immediate transferor is authorized to give particular instructions.

Basically, the section requires such bank to follow only the instructions of its immediate transferor; and the bank is protected when it does so. There are two exceptions when a bank is not necessarily safe in following only the orders of its immediate transferor: (a) Conversion situations under GS 25-3-419 [now GS 25-3-420]; and (b) restrictive indorsement problems under articles 3 and 4. (See GS 25-3-205 [omitted from 1995 revision], 25-3-206, 25-3-419 [now GS 25-3-420], 25-3-603 [now GS 25-3-602], 25-4-205.)

The section does not apply to "payor banks" which have greater duties under other provisions of articles 3 and 4.

§ 25-4-204. Methods of sending and presenting; sending directly to payor.

(a) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved, and the method generally used by it or others to present those items.

(b) A collecting bank may send:

(1) An item directly to the payor bank;

(2) An item to a nonbank payor if authorized by its transferor; and

(3) An item other than documentary drafts to a nonbank payor, if authorized by federal reserve regulation or operating circular, clearing-house rule, or the like.

(c) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made. (1921, c. 4, s. 39; C.S., s. 220(n); 1949, c. 818; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (b)(1) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases in which a bank is a payor. Since nonbank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing-house procedures to forward certain types of items to certain nonbank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (b)(3) affirmatively approves direct sending of any item other than documentary drafts to any nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule or the like.

On the other hand subsection (b)(2) approves sending any item directly to a nonbank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4-203. However, if a transferor other than the owner of the item, e.g., a prior collecting bank, authorizes a direct sending to a nonbank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3-501(b) provides where presentment may be made. This provision is expressly subject to Article 4. Section 4-204(c) specifically approves presentment by a presenting bank at any place requested by the payor bank or other payor. The time when a check is received by a payor bank for presentment is governed by Regulation CC Section 229.36(b).

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This simply states a general rule demanding reasonably prompt forwarding of items, taking into account all relevant factors.

Subsection (2) [now (b)]: (a) Continues the rule GS 53-58 permitting direct presentment to a *payor bank.*

Subsequent study may reveal that this subsection needs to be expanded to expressly approve other direct presentments for instruments payable "at" or "through" a bank.

(b) and (c) Permit direct presentment to *nonbank* payors only when such direct presentment is authorized.

CASE NOTES

***Editor's Note.** — The cases cited below were decided under prior statutory provisions.*

Dealings Presumed to Contemplate Statute. — Banks must be presumed to have dealt with each other with respect to a statute of the state in which a check was deposited for collection, defining the rights and liabilities of banks to which checks are forwarded for collection. Federal Land Bank v. Barrow, 189 N.C. 303, 127 S.E. 3 (1925), citing Malloy v. Federal Reserve Bank, 281 F. 997 (E.D.N.C. 1922), aff'd, 291 F. 763 (4th Cir. 1923).

Sending Check to Drawee Bank Held Proper. — Under former statute, the sending of a cashier's check by the forwarding bank to the drawee bank for collection was held "due diligence." Federal Land Bank v. Barrow, 189 N.C. 303, 127 S.E. 3 (1925).

A collecting bank makes a good presentment of a check for payment by forwarding it to the drawee bank in another city by mail. Braswell v. Citizens Nat'l Bank, 197 N.C. 229, 148 S.E. 236 (1929).

Risk of Accepting Anything But Money Not Affected. — Former statute was applicable only when the liability of a bank which had received for collection or deposit a check drawn on a bank located in another city or town to the holder or depositor of the check was involved. The statute could not be held to affect the right of the drawer of the check to have the payee or his agent for collection demand money in payment of his check or take the risk of accepting anything but money. Dewey Bros. v. Margolis, 195 N.C. 307, 142 S.E. 22 (1928). See § 25-4-211.

§ 25-4-205. Depositary bank holder of unindorsed item.

If a customer delivers an item to a depositary bank for collection:

(1) The depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of G.S. 25-3-302, it is a holder in due course; and

(2) The depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

Section 3-201(b) provides that negotiation of an instrument payable to order requires indorsement by the holder. The rule of former Section 4-205(1) was that the depositary bank may supply a missing indorsement of its customer unless the item contains the words "payee's indorsement required" or the like. The cases have differed on the status of the depositary bank as a holder if it fails to supply its customer's indorsement. *Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers,* 446 N.Y.S.2d 797 (N.Y.Apo. Div.4th Dept. 1981), *rev'd,* 455 N.Y.S.2d 565 (N.Y. 1982). It is common practice for depositary banks to receive unindorsed checks under so-called "lock-box" agreements from customers who receive a high volume of checks. No function would be served by requiring a depositary bank to run these items through a machine that would supply the customer's indorsement except to afford the drawer and the subsequent banks evidence that the proceeds of the item reached the customer's account. Paragraph (1) provides that the depositary bank becomes a holder when it takes the item for deposit if the depositor is a holder. Whether it supplies the customer's indorsement is immaterial. Paragraph (2) satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account. This warranty runs not only to collecting banks and to the payor bank or nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1): This subsection permits a missing indorsement to be supplied by a *depos-*

itary bank (i.e., "the first bank to which an item is transferred for collection," GS 25-4-105 (a)).

Presumably, subsequent banks that take "negotiable instruments" containing either of the two authorized types of substitute indorsements will be "holders" and may be HDC's under GS 25-4-208 [25-4-207.1] and 25-4-209 [25-4-207.2]. Also see GS 25-4-206 on a "transfer" that is not a "negotiation."

Note that a depositary bank may only supply an "indorsement of the *customer* which is *necessary for title.*" Thus:

(1) On *bearer* paper (for which no indorsement is necessary to transfer title) the contract of a customer may not be enlarged to those of an indorser (GS 25-3-414 [now GS 25-3-414]) by the indorsement of the bank. However, he still makes the warranties of GS 25-3-417 [now GS 25-3-416] (2) and 25-4-207, and

(2) Also the bank is not authorized to supply the indorsement of any party prior to the customer who presents the item for collection.

(3) Furthermore, it appears that this section does not apply to indorsement of one who "cashes" a check.

Possible amendment note: There is some doubt whether a signature is ever really necessary to pass title (GS 25-3-201 [now GS 25-3-203]); and further study may reveal that subsection (1) (a) needs to be amended.)

Subsection (2): This in effect restates the rule of GS 25-3-206 on the limited effect of restrictive indorsements. The two sections differ as follows:

(1) GS 25-3-206 applies only to negotiable instruments, while GS 25-4-205 [omitted from 1995 revision] applies to any "item."

(2) GS 25-3-206 (2) adds the words "or the person presenting for payment."

CASE NOTES

Cited in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-206. Transfer between banks.

Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. If the transfer is between banks, this section takes the place of the more formal requirements of Section 3-201.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This permits a *transfer* without the indorsement of the transferor. However, it does not mean that a mere identification of the transferor is the equivalent of an indorsement so as to have a negotiation of a negotiable instrument. Thus, a bank taking under this informal procedure cannot be a *holder* unless the instrument is bearer paper.

§ 25-4-207. Transfer warranties.

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) The warrantor is a person entitled to enforce the item;
(2) All signatures on the item are authentic and authorized;
(3) The item has not been altered;

(4) The item is not subject to a defense or claim in recoupment (G.S. 25-3-305(a)) of any party that can be asserted against the warrantor; and

(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in G.S. 25-3-115 and G.S. 25-3-407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(c) A person to whom the warranties under subsection (a) of this section are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(d) The warranties stated in subsection (a) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(e) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

Except for subsection (b), this section conforms to Section 3-416 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-416. Subsection (b) provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a "without recourse" indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsections (1), (2) and (3): The warranty provisions of these subsections are extensive; and they apply to both negotiable and nonnegotiable instruments. By comparison the substantially similar warranties of GS 25-3-417 [now GS 25-3-416 and 25-3-417] apply only to negotiable instruments.

Note that the warranties of this section apply regardless of the type of indorsement or whether there was an indorsement. This differs from GS 25-3-417 [now GS 25-3-416 and 25-3-417], which varies the quantity of warranties according to the type of indorsement.

A detailed analysis of the elaborate warranty provisions of subsections (1), (2) and (3) is beyond the scope of this preliminary commentary. However, for those who wish to more fully explore this section, and related GS 25-3-417, reference is made to the comprehensive New Jersey Study 308-314, 391-393; and to Clarke, Bailey, and Young, Bank Deposits and Collections—UCC 130-143 (1963).

In addition to providing for various warranties, the last sentence of subsection (2) creates a *contract* for each customer and collecting bank that transfers an item and receives consideration. Each such party *"engages* that upon dishonor and any necessary notice of dishonor and protest he will *take up* the item."

The "take up" requirement of subsection (2) should be compared with the limited damages provision of subsection (3).

Subsection (4): This subsection grants a limited discharge to a warrantor who is damaged by unreasonable delay of a warrantee in making claim for breach of warranty.

Legal Periodicals. — For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

CASE NOTES

"Good Title". — For purposes of deciding whether to impose liability on a collecting bank on summary judgment, "good title" under this section means only that a collecting bank is warranting that it is presenting a check whose indorsements appear to be genuine. If in fact such indorsement is not genuine, then the collecting bank is not admitting strict liability for its breach of warranty, but can in turn sue the previous collecting bank. North Carolina Nat'l Bank v. Hammond, 298 N.C. 703, 260 S.E.2d 617 (1979).

Unproven and contested allegations of forged indorsement are insufficient as a matter of law to show a breach of warranty of good title under this section. North Carolina Nat'l Bank v. Hammond, 298 N.C. 703, 260 S.E.2d 617 (1979).

Action for Breach of Presentment Warranties. — Although a collecting bank was entitled to recover on its claim that a payor bank unlawfully charged back a check to the collecting bank's account, after the drawer had discovered a missing endorsement, the payor bank was entitled to recover on its claim against the collecting bank for breach of presentment warranty of good title. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

No Warranties Between Branches. — Where the Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S. 25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

Applied in First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972).

§ 25-4-207.1. Presentment warranties.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;
(2) The draft has not been altered; and
(3) The warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) of this section based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under G.S. 25-3-404 or G.S. 25-3-405 or the drawer is precluded under G.S. 25-3-406 or G.S. 25-4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

This section conforms to Section 3-417 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-417. "Draft" is defined in Section 4-104 as including an item that is an order to pay so as to make clear that the term "draft" in Article 4 may include items that are not instruments within Section 3-104.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had numbered this section as 25-4-208.

CASE NOTES

Breach of Warranty. — Summary judgment was properly granted in favor of a paying bank on its breach of warranty claims against a presenting bank with respect to an altered check; the paying bank's failure to investigate after payment of the check was irrelevant to its good faith in paying the check, the failure of the bank's processing procedures to detect the alteration did not amount to dishonesty or unfair dealing, and the check drawer's failure to take certain precautions did not amount to a failure of ordinary care that substantially contributed to the alteration. Wachovia Bank, N.A. v. FRB, 338 F.3d 318, 2003 U.S. App. LEXIS 15014 (4th Cir. 2003).

§ 25-4-207.2. Encoding and retention warranties.

(a) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(b) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(c) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Encoding and retention warranties are included in Article 4 because they are unique to the bank collection process. These warranties are breached only by the person doing the encoding or retaining the item and not by subsequent banks handling the item. Encoding and check retention may be done by customers who are payees of a large volume of checks; hence, this section imposes warranties on customers as well as banks. If a customer encodes or retains, the depositary bank is also liable for any breach of this warranty.

2. A misencoding of the amount on the MICR line is not an alteration under Section 3-407(a) which defines alteration as changing the contract of the parties. If a drawer wrote a check for $2,500 and the depositary bank encoded $25,000 on the MICR line, the payor bank could debit the drawer's account for only $2,500. This subsection would allow the payor bank to hold the depositary bank liable for the amount paid out over $2,500 without first pursuing the person who received payment. Intervening collecting banks would not be liable to the payor bank for the depositary bank's error. If a drawer wrote a check for $25,000 and the depositary bank encoded $2,500, the payor bank becomes liable for the full amount of the check. The payor bank's rights against the depositary bank depend on whether the payor bank has suffered a loss. Since the payor bank can debit the drawer's account for $25,000, the payor bank has a loss only to the extent that the drawer's account is less than the full amount of the check. There is no requirement that the payor bank pursue collection against the drawer beyond the amount in the drawer's account as a condition to the payor bank's action against the depositary bank for breach of warranty. See *Georgia Railroad Bank & Trust Co. v. First National Bank & Trust,* 229 S.E.2d 482 (Ga. App. 1976), aff'd, 235 S.E.2d 1 (Ga. 1977), and *First National Bank of Boston v. Fidelity Bank, National Association,* 724 F.Supp. 1168 (E.D. Pa. 1989).

3. A person retaining items under an electronic presentment agreement (Section 4-110) warrants that it has complied with the terms of the agreement regarding its possession of the item and its sending a proper presentment notice. If the keeper is a customer, its depositary bank also makes this warranty.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had numbered this section as 25-4-209.

§ 25-4-208. Security interest of collecting bank in items, accompanying documents and proceeds.

(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) In case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) In case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(3) If it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents, and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or possession or control of the accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Article 9, but:

(1) No security agreement is necessary to make the security interest enforceable (G.S. 25-9-203(b)(3)a.);

(2) No filing is required to perfect the security interest; and

(3) The security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds. (1965, c. 700, s. 1; 1995, c. 232, s. 2; 2000-169, s. 17; 2006-112, s. 42.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several collecting banks are agents of the customer (Section 4-201). A collecting agent may properly make advances on the security of paper held for collection, and acquires at common law a possessory lien for these advances. Subsection (a) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3-303, 4-211 [25-4-209]) and a holder in due course if it satisfies the other requirements for that status (Section 3-302). Subsection (a) does not derogate from the banker's general common law lien or right of setoff against indebtedness owing in deposit accounts. See Section 1-103. Rather subsection (a) specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (b) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that the vast majority of items handled for collection are in fact collected. The first sentence of subsection (c) reflects the fact that in the normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of noncollection in which the security interest may be important.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [(a)]: This important section gives a bank a security interest in various items; thus enabling a bank to be protected against other claims against items and proceeds; also, the security interest will permit a bank to be a holder for value and perhaps an HDC under GS 25-4-209 [25-4-207.2].

Because the HDC problem is one of the most important covered by GS 25-4-208 [25-4-207.1] and 25-4-209 [25-4-207.2], the two sections are considered together here. By reading these two sections together, it is clear that even a collecting bank may possibly be an HDC; and often the most important facit of the HDC issue is whether the bank is a holder for value.

Past North Carolina decisions have been rather vague in determining whether a collecting bank can be an HDC:

(a) A bank taking for collection is not an HDC. Manufacturers Fin. Co. v. Amazon Cotton Mills Co., 187 N.C. 233, 121 S.E. 439 (1924); First Nat'l Bank v. Rochamora, 193 N.C. 1, 136 S.E. 259 (1927).

(b) A bank may be HDC of draft even though custom permits a charge back against depositor. Elm City Lumber Co. v. Childerhose, 167

N.C. 34, 83 S.E. 22 (1914).

(c) Bank may be HDC of check even when it charges back against depositor's account if amounts against which charge back is made are later removed when items representing amounts are returned unpaid. Standard Trust Co. v. Commercial Nat'l Bank, 240 Fed. 303 (4th Cir. 1917).

(d) A bank which reserves a right to charge back, by express agreement or one implied from a course of dealing, and not by reason of liability on the indorsement, is an agent for collection and not a purchaser. Manufacturers Fin. Co. v. Amazon Cotton Mills Co., 187 N.C. 233, 121 S.E. 439 (1924).

(e) Regardless of formal statements on a deposit slip that deposits are accepted for collection only, "if the facts and circumstances surrounding the making of the deposit indicate *at the time it was made* it was the *actual agreement and intention* of the parties that the depositor might withdraw completely the deposit, or otherwise completely employ it, and he does so, the title to the item deposited thereupon passes to the bank"; and it may be an HDC. (Emphasis added.) State Planters Bank v. Courtesy Motors, Inc., 250 N.C. 466, 109 S.E.2d 189 (1959).

(f) Where bank permits an uncollected draft received for deposit and collection to be drawn against, the bank has rights superior to an attaching creditor of the depositor. Ledwell v. Shenandoah Milling Co., 215 N.C. 371, 1 S.E.2d 841 (1939).

Despite certain inconsistencies in decisions and many unsettled areas, it seems fair to say that North Carolina has in the past usually permitted banks to be HDC's when they could not make themselves harmless by charge back against the depositor's account. GS 25-4-208 [25-4-207.1] and 25-4-209 [25-4-207.2] will continue and expand this principle.

In short, the new rules are:

(1) A bank in the collecting chain basically occupies a technical position of an agent only (GS 25-4-201); but

(2) it obtains certain security interests in the item under GS 25-4-208 [25-4-207.1]; and

(3) under GS 25-4-209 [25-4-207.2] it becomes a holder for value and may be an HDC.

See also North Carolina Comment to GS 25-4-209 [25-4-207.2].

Subsection (2) [(b)]: This subsection adopts the first-in, first-out (FIFO) rule for determining when credits have been drawn against. This rule applies to all of GS 25-4-208 [25-4-207.1]. To the same effect is Standing Stone Nat'l Bank v. Walser, 162 N.C. 53, 77 S.E. 1006 (1913).

Subsection (3) [(c)]: In this subsection (a) and (b) [(1) and (2)] state that no security agreement or filing under article 9 is necessary to perfect a bank's security interest. (3) (c) [(c) (3)] gives a bank a priority over other competing security interests.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-210.

Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 42, effective October 1, 2006, inserted "possession or control of the" in the introductory language of subsection (c); and made a minor punctuation change in subdivision (c)(3).

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

CASE NOTES

Bank May Pay Against Uncollected Item. — North Carolina law appears to contemplate that, in the exercise of ordinary care, a bank may conclude to pay against an uncollected item, because it gives a bank a security interest in an item against which it has made an advance. Fidelity & Deposit Co. v. Bank of Bladenboro, 596 F.2d 632 (4th Cir. 1979).

Status of Bank As "Collecting Bank" vs "Payor Bank". — Where the Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S. 25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

A defendant bank, upon dishonor of a draft, did not have a duty to send the titles of automobiles to the bank to which plaintiffs had issued a banker's blanket bond, where the titles were "accompanying documents" and where the bank to which the plaintiffs issued the bond never established a "security interest" in those titles prior to the time the defendant bank sent them back to the drawee after they were dishonored. Fidelity & Deposit Co. v. Bank of Bladenboro, 472 F. Supp. 885 (E.D.N.C. 1978), aff'd, 596 F.2d 632 (4th Cir. 1979).

Cited in Southern Nat'l Bank v. Universal Acceptance Corp., 2 N.C. App. 319, 163 S.E.2d 10 (1968).

§ 25-4-209. When bank gives value for purposes of holder in due course.

For purposes of determining its status as a holder in due course, a bank has given value to the extent it has a security interest in an item, if the bank otherwise complies with the requirements of G.S. 25-3-302 on what constitutes a holder in due course. (1899, c. 733, s. 27; Rev., s. 2175; C.S., s. 3007; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 (Section 3-303). The section does not prescribe a security interest under Section 4-210 [25-4-208] as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

As noted in the North Carolina Comment to GS 25-4-208 [25-4-207.1], this awkwardly worded section permits a bank to be a holder for value to the extent that it has a security interest as defined in GS 25-4-208 [25-4-207.1].

In order to be an HDC, however, the bank must also meet the other tests of GS 25-3-302 for HDC status.

Even though a bank does not qualify as an HDC in its own right, it may be a *derivative* HDC under the so-called "shelter" provisions of GS 25-3-201 [now GS 25-3-203].

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-1-211 [25-4-211].

CASE NOTES

Deposit of Draft for Collection. — If drafts, deposited by a customer for his credit, returned unpaid, are charged back to the customer's account and returned to him, this constitutes only an agency for collection. Latham v. Spragins, 162 N.C. 404, 78 S.E. 282 (1913), decided under former statutory provisions.

Application of Proceeds of Draft to Antecedent Debt. — If the drawer of a draft was in debt to the bank, and the draft was discounted by it and the proceeds applied in discharge of such balance, the bank became the owner of the draft, and a purchaser for value to the extent of the goods described in the bills of lading. Latham v. Spragins, 162 N.C. 404, 78 S.E. 282 (1913), decided under former statutory provisions.

Assignment of Draft to Bank for Valuable Consideration. — Where a bank, for a valuable consideration, takes an assignment of a bill of lading with draft attached, the consignee of the goods takes them subject to the rights of the holder of the bill of lading for the amount of the draft, and he cannot retain the price of the goods on account of a debt due him from the consignor. Willard Mfg. Co. v. Tierney, 133 N.C. 630, 45 S.E. 1026 (1903), decided under former statutory provisions.

Cited in Southern Nat'l Bank v. Universal Acceptance Corp., 2 N.C. App. 319, 163 S.E.2d 10 (1968).

§ 25-4-210. Presentment by notice of item not payable by, through, or at a bank; liability of drawer or indorser.

(a) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under G.S. 25-3-501 by the close of the bank's next banking day after it knows of the requirement.

(b) If presentment is made by notice and payment, acceptance, or request for compliance with a requirement under G.S. 25-3-501 is not received by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on nonbank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges drawers and indorsers. Presentment under this section is good presentment under Article 3. See Section 3-501.

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This subsection permits a collecting bank to make a proper presentment to the party who is to pay or accept by merely sending a *written notice* that the bank holds the item for payment or acceptance. Thus, the bank need not actually present the item itself.

As implied in GS 25-4-204 (2) (b) and (c), it is often wrong for a bank to send collection items directly to a nonbank payor; and this section will allow a written notice presentment without the bank's either personally presenting or mailing the items.

However, since (1) notice must be sent in time to be received by the day when presentment is due, and (2) since the bank must permit the presentee to see the instrument, etc., as provided by GS 25-3-505 [now GS 25-3-501] (rights of party to whom presentment is made), the presenting bank should be in a position to satisfy the demands of the presentee given under GS 25-3-505 by not later than the close of the next day after the bank learns of the presentee's demands ("requirements").

Further study may reveal that this subsection needs to be revised to correlate more closely with GS 25-3-505.

(*Note:* This is but one of several areas where articles 3 and 4 apply somewhat different rules to a particular situation. While it is not suggested that North Carolina amend the UCC without prior consultation with the Permanent Editorial Board, we may wish to take the initiative in proposing some minor changes for action by all adopting states.)

Subsection (2) [now (b)]: This subsection states the rules for treating an instrument as dishonored after "notice presentment." It further says that a bank *may* charge secondary parties by sending notice of the *facts.* It does not specifically state the *duty* of a bank to notify of the facts. This duty is partially covered by GS 25-4-202.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-212.

§ 25-4-211. Medium and time of settlement by bank.

(a) With respect to settlement by a bank, the medium and time of settlement may be prescribed by federal reserve regulations or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(1) The medium of settlement is cash or credit to an account in a Federal Reserve Bank of or specified by the person to receive settlement; and

(2) The time of settlement is:

(i) With respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) With respect to tender of settlement by credit in an account in a Federal Reserve Bank, when the credit is made;

(iii) With respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) With respect to tender of settlement by a funds transfer, when payment is made pursuant to G.S. 25-4A-406(a) to the person receiving settlement.

(b) If the tender of settlement is not by a medium authorized by subsection (a) of this section or the time of settlement is not fixed by subsection (a), no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(c) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(1) Presents or forwards the check for collection, settlement is final when the check is finally paid; or

(2) Fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(d) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) sets forth the medium of settlement that the person receiving settlement must accept. In nearly all cases the medium of settlement will be determined by agreement or by Federal Reserve regulations and circulars, clearing-house rules, and the like. In the absence of regulations, rules or agreement, the person receiving settlement may demand cash or credit in a Federal Reserve bank. If the person receiving settlement does not have an account in a Federal Reserve bank, it may specify the account of another bank in a Federal Reserve bank. In the unusual case in which there is no agreement on the medium of settlement and the bank making settlement tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred under subsection (b) unless the person receiving settlement accepts the settlement tendered. For example, if a payor bank, without agreement, tenders a teller's check, the bank receiving the settlement may reject the check and return it to the payor bank or it may accept the check as settlement.

2. In several provisions of Article 4 the time that a settlement occurs is relevant. Subsection (a) sets out a general rule that the time of settlement, like the means of settlement, may be prescribed by agreement. In the absence of agreement, the time of settlement for tender of the common agreed media of settlement is that set out in subsection (a)(2). The time of settlement by cash, cashier's or teller's check or authority to charge an account is the time the cash, check or authority is sent, unless presentment is over the counter in which case settlement occurs upon delivery to the presenter. If there is no agreement on the time of settlement and the tender of settlement is not made by one of the media set out in subsection (a), under subsection (b) the time of settlement is the time the settlement is accepted by the person receiving settlement.

3. Subsections (c) and (d) are special provisions for settlement by remittance drafts and authority to charge an account in the bank receiving settlement. The relationship between final settlement and final payment under Section 4-215 [25-4-213] is addressed in subsection (b) of Section 4-215 [25-4-213(b)]. With respect to settlement by cashier's checks or teller's checks, other than in response to over-the-counter presentment, the bank receiving settlement can keep the risk that the check will not be paid on the bank tendering the check in settlement by acting to initiate collection of the check within the midnight deadline of the bank receiving settlement. If the bank fails to initiate settlement before its midnight deadline, final settlement occurs at the midnight deadline, and the bank receiving settlement assumes the risk that the check will not be paid. If there is no agreement that permits the bank tendering settlement to tender a cashier's or teller's check, subsection (b) allows the bank receiving the check to reject it, and, if it does, no settlement occurs. However, if the bank accepts the check, settlement occurs and the time of final settlement is governed by subsection (c).

With respect to settlement by tender of authority to charge the account of the bank making settlement in the bank receiving settlement, subsection (d) provides that final settlement does not take place until the account charged has available funds to cover the amount of the item. If there is no agreement that permits the bank tendering settlement to tender an authority to charge an account as settlement, subsection (b) allows the bank receiving the tender to reject it. However, if the bank accepts the authority, settlement occurs and the time of final settlement is governed by subsection (d).

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1): This subsection states the several appropriate settlements that can safely be taken by a collecting bank. The risk that such noncash settlements may not be realizable in cash is shifted from the collecting bank to the owner of the item.

A somewhat similar rule is found in GS 53-71; however, GS 25-4-211 (1) [25-4-209 (1)] gives much broader protection to the collecting bank.

Under GS 53-71 the emphasis is on the propriety of noncash *payments by the payor* bank; and only indirectly answered are the questions of: (1) When the drawer is discharged and (2) whether the collecting bank has accepted a proper payment. (See cases annotated under GS 53-71).

Under GS 25-4-211 [25-4-209], the emphasis is on the propriety of the *acceptance* of a particular medium of payment by the collecting bank. The further question of final payment by the drawer is covered in GS 25-4-213 [25-4-211]. (See North Carolina Comment).

Subsection (1) does not cover all types of settlement, and the specific listing of certain usual types of remittances does not imply that other types of remittances are improper (GS 25-4-103 (4)). See Official Comment 5.

Subsection (2): This subsection relieves a collecting bank from liability if an authorized noncash receipt is later dishonored.

Subsection (3): This subsection complements subsections (1) and (2) by stating when a settlement by means of a remittance instrument or an authorization to charge becomes final as to both the *person* making and the person receiving the settlement. By using the term "person" these rules apply to nonbank payors and nonbank customers for whom items are being collected, as well as to bank payors and collecting banks.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-213.

§ 25-4-212. Right of charge-back or refund; liability of collecting bank; return of item.

(a) If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (G.S. 25-4-301).

(d) The right to charge back is not affected by:

(1) Previous use of a credit given for the item; or

(2) Failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of the value of an item payable in foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items." Statistically, this practice of settling provisionally first and then awaiting final payment is justified because the vast majority of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those

cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment, provision is made in subsection (a) for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund.

2. Various causes of a bank's not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (a). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise."

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item. The second sentence of subsection (a) adopts the view of *Appliance Buyers Credit Corp. v. Prospect National Bank,* 708 F.2d 290 (7th Cir. 1983), that if the midnight deadline for returning an item or giving notice is not met, a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

4. Subsection (b) states when an item is returned by a collecting bank. Regulation CC, Section 229.31 preempts this subsection with respect to checks by allowing direct return to the depositary bank. Because a returned check may follow a different path than in forward collection, settlement given for the check is final and not provisional except as between the depositary bank and its customer. Regulation CC Section 229.36(d). See also Regulations CC Sections 229.31(c) and 229.32(b). Thus owing to the federal preemption, this subsection applies only to noncheck items.

5. The rule of subsection (d) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even if nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(e); see also Section 4-402).

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(e).

7. Subsection (f) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107. Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This subsection permits a collecting bank under stated circumstances to charge back against its customer's account when the collecting bank is unable to receive a final settlement.

Subsection (2) [omitted by the 1995 amendment]: This subsection is optional; and it would permit the use of direct return procedures. As direct return procedures are now used by many banks in North Carolina, it appears that this subsection should be adopted in North Carolina.

Subsection (3) [now (c)]: This subsection covers the right of charge-back by a depositary-payor bank. Basically such right is governed by GS 25-4-301 to which incorporating reference is made.

Subsection (4) [now (d)]: This subsection merely preserves other remedies of a bank against its customer or other party.

Subsection (5) [now (e)]: This subsection states a technical rule on foreign currency.

There was little or no statutory law in North Carolina on the matters in this entire section.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-214.

CASE NOTES

When a Debt Obligation Is Created. — Where the Chapter 7 trustee alleged a check kiting scheme in a preferential transfer complaint whereby a secured creditor wire transferred funds into the debtor's operating account based on the debtor's deposits into the blocked account that was daily swept by the secured creditor, and the debtor then issued "on us" checks from the operating account and deposited them into the blocked account, and the bank had extended provisional credit on the blocked account, under the provisional credit provisions of G.S. 25-4-201 and G.S. 25-4-212, for purposes of 11 U.S.C.S. § 547(b)(2), the bank was owed an "antecedent debt" when the wire transfer into the operating account was made, and under G.S. 25-4-105, the bank was not both a "collecting bank" and a "payor bank," although the checks were deposited into the blocked account at two branches, but the accounts were housed at another branch, and the bank had no claim of a security interest under G.S. 25-4-208, because G.S. 25-4-106 did not provide for individual branches of a bank to be treated as separate banks for all purposes, and warranties by one branch to another branch under G.S. 25-4-207 and G.S. 25-4-208 (each considered as a separate bank), did not make sense. Moseley v. Arth (In re Vendsouth, Inc.), — Bankr. —, 2003 Bankr. LEXIS 1437 (Bankr. M.D.N.C. Oct. 9, 2003).

Applied in North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978).

§ 25-4-213. Final payment of item by payor bank; when provisional debits and credits become final; when certain credits become available for withdrawal.

(a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) Paid the item in cash;

(2) Settled for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement; or

(3) Made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule, or agreement.

(b) If provisional settlement for an item does not become final, the item is not finally paid.

(c) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(d) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(e) Subject to (i) applicable law stating a time for availability of funds, and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) If the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time.

(2) If the bank is both the depositary bank and the payor bank, and the item is finally paid, — at the opening of the bank's second banking day following receipt of the item.

(f) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit. (1899, c. 733, s. 137; Rev., s. 2287; C.S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. By the definition and use of the term "settle" (Section 4-104(a)(11)) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (a) defines when settlement for an item constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-payment orders, legal process and setoffs (Section 4-303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See Section 4-215(c) [25-4-213(c)]. Final payment of an item by the payor bank fixes preferential rights under Section 4-216 [25-4-214].

2. If an item being collected moves through several states,e.g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (a) recognizes that final payment does not take place, in this hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are *proceeds* of the item.

3. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Subsection (a)(1) recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4-104(a)(11) defines "settle" as meaning "to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final." Subsection (a)(2) of Section 4-215 [25-4-213(a)(2)] provides that an item is finally paid by a payor bank when the bank has "settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement." Former subsection (1)(b) is modified by subsection (a)(2) to make clear that a payor bank cannot make settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from a statute (e.g., Section 4-301), clearing-house rule or other agreement. Subsection (a)(2) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If under statute, clearing-house rule or agreement, a right of revocation of the settlement exists, the settlement is provisional. Conversely, if there is an absence of a right to revoke under statute, clearing-house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4-301. The underlying theory and reason for deferred posting statutes (Section 4-301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case in which Section 4-301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (a)(2) of Section 4-215 [25-4-213(a)(2)] does not operate, and such provisional settlement does not constitute final payment of the item. With respect to checks, Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of this provision to Article 4 is discussed in the Commentary to that section.

A second important example of a right to revoke a settlement is that arising under clearing-house rules. It is very common for clearing-house rules to provide that items exchanged and settled for in a clearing (e.g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than

2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e.g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of an agreement allowing the payor bank to revoke a settlement is a case in which the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, the agreement keeps the receipt or credit provisional and avoids its being either final settlement or final payment.

The most important application of subsection (a)(2) is that in which presentment of an item has been made over the counter for immediate payment. In this case Section 4-301(a) does not apply to make the settlement provisional, and final payment has occurred unless a rule or agreement provides otherwise.

5. Former Section 4-213(1)(c) provided that final payment occurred when the payor bank completed the "process of posting." The term was defined in former Section 4-109 [25-4-109, repealed]. In the present Article, Section 4-109 [25-4-109, repealed] has been deleted and the process-of-posting test has been abandoned in Section 4-215(a) [25-4-213(a)] for determining when final payment is made. Difficulties in determining when the events described in former Section 4-109 [25-4-109, repealed] take place make the process-of-posting test unsuitable for a system of automated check collection or electronic presentment.

6. The last sentence of former Section 4-213(1) is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 stating that the payor bank can defend against liability for accountability by showing that it has already settled for the item. But, at least with respect to former Section 4-213(1)(c), such a provision was needed because under the process-of-posting test a payor bank may have paid an item without settling for it. Now that Article 4 has abandoned the process-of-posting test, the sentence is no longer needed. If the payor bank has neither paid the item nor returned it within its midnight deadline, the payor bank is accountable under Section 4-302.

7. Subsection (a)(3) covers the situation in which the payor bank makes a provisional settlement for an item, and this settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing-house rule or agreement. An example of this type of situation is the clearing-house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing-house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (a)(3) provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4-301. In this situation subsection (a)(3) of Section 4-215 [25-4-213(a)(3)] provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4-301, the item is finally paid at midnight on Tuesday. With respect to checks, Regulation CC Section 229.30 (c) allows an extension of the midnight deadline under certain circumstances. If a bank does not expeditiously return a check liability may accrue under Regulation CC Section 229.38. For the relationship of that liability to responsibility under this Article, see Regulation CC Sections 229.30 and 229.38.

8. Subsection (b) relates final settlement to final payment under Section 4-215 [25-4-213]. For example, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under Section 4-213(c), subsection (b) provides that final payment has not occurred. If the item is not paid, the drawer remains liable, and under Section 4-302(a) the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, subsection (b) is an exception to subsection (a)(3). Even if the payor bank has not returned an item by its midnight deadline there is still no final payment if provisional settlement had been made and settlement failed to become final. However, if presentment of the item was over the counter for immediate payment, final payment has occurred under Section 4-215(a)(2) [25-4-213(a)(2)]. Subsection (b) does not apply because the settlement was not provisional. Section 4-301(a). In this case the presenting person, often the payee of the item, has the right to demand cash or the cash equivalent of federal reserve credit. If the pre-

senting person accepts another medium of settlement such as a cashier's or teller's check, the presenting person takes the risk that the payor bank may fail to pay a cashier's check because of insolvency or that the drawee of a teller's check may dishonor it.

9. Subsection (c) states the country-wide usage that when the item is finally paid by the payor bank under subsection (a) this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only if the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place if the payor bank remits for the item by sending some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item by sending a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

10. Subsection (d) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(a). If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-213) [25-4-211].

11. Subsection (e) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (e)(1) deals with the situation in which a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to receive return of the item and the item has not been received within that time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument, the means for clearing such instrument, and other pertinent facts. With respect to checks Regulation CC Sections 229.10-229.13 or similar applicable state law (Section 229.20) control. This is also time for the situation described in Comment 12.

12. Subsection (e)(2) deals with the situation of a bank that is both a depositary bank and a payor bank. The subsection recognizes that if A and B are both customers of a depositary-payor bank and A deposits B's check on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of Section 4-301 to reach the bookkeeper for B's account at some time on Tuesday, and, if there are insufficient funds in B's account, to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check, the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (e)(2) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This subsection states the several times at which a payment by a payor bank becomes final. This affects the discharge of the *drawer* and indorsers, as well as the rights of other parties in the collection chain.

The time of final payment is important for several reasons:

(1) It is a factor relative to priorities between items and notices, stop-orders, legal process

and set-offs (GS 25-4-303).

(2) It is the "end of the line" in the collecting process and the turn around point commencing the return flow of proceeds.

(3) It is the point at which many provisional settlements become final (see GS 25-4-213 (2) [25-4-211 (a)]).

(4) Final payment of an item by the payor fixes preferences under GS 25-4-214 (1) and (2) [25-4-212 (1) and (2)].

Aside from GS 25-144, which contained a provision on "midnight deadline," there was little or no statutory law in North Carolina on this matter.

A long Official Comment explains this section, and a nutshell summary is not suitable here. However, Official Comment 2 notes that subsection (1) [now (a)] adopts the policy that final payment occurs at some point in the processing of the item by the *payor* bank. Thus, it rejects cases holding final payment is influenced by: (1) Whether a remittance draft was *accepted* by the presenting bank: Dewey Bros. v. Margolis & Brooks, 195 N.C. 307, 142 S.E. 22 (1928); or (2) whether the remittance draft itself was *paid:* Cleve v. Craven Chem. Co., 18 F.2d 711 (4th Cir. 1927).

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-215.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Right to Refuse to Allow Withdrawal Against Uncollected Funds. — Each time a depositor seeks to make a withdrawal against uncollected funds, the bank is entitled to choose whether to stand on or waive its right to refuse to allow such a withdrawal. Discount Auto Mart, Inc. v. Bank of N.C., 45 N.C. App. 543, 263 S.E.2d 41 (1980).

A bank did not waive its right to refuse to allow a depositor to make withdrawals from his account against uncollected funds by allowing him to make such withdrawals over a period of 15 months. Discount Auto Mart, Inc. v. Bank of N.C., 45 N.C. App. 543, 263 S.E.2d 41 (1980).

Crediting Customer Is Final Payment. — When a bank credits a depositor with the amount of a check drawn upon it by another customer, and there is no want of good faith on the part of the depositor, the act of crediting is equivalent to a payment in money, and the bank cannot recall or repudiate the payment because later it is ascertained that the drawer was without funds to meet the check, even though when the payment was made the officials labored under the mistake that there were sufficient funds. Woodward v. Savings & Trust Co., 178 N.C. 184, 100 S.E. 304 (1919), decided under former statutory provisions.

Action Against Collecting Bank for Breach of Presentment Warranty. — Although a collecting bank was entitled to recover on its claim that a payor bank unlawfully charged back a check to the collecting bank's account, after the drawer had discovered a missing endorsement, the payor bank was entitled to recover on its claim against the collecting bank for breach of presentment warranty of good title. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

A payor bank's right to recover for breach of presentment warranties does not undo or negate its final payment to collecting bank under subsection (1) of this section. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

Applied in North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978).

§ 25-4-214. Insolvency and preference.

(a) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(b) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(c) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement's becoming final if the finality occurs automatically upon the lapse of certain time or the happening of certain events.

(d) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against the collecting bank. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in the process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. On the other hand, some law previous to this Act may be relevant. See Note, Uniform Commercial Code: Stopping Payment of an Item Deposited with an Insolvent Depositary Bank, 40 Okla. L. Rev. 689 (1987). Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of *Jennings v. United States Fidelity & Guaranty Co.,* 294 U.S. 216, 55 S.Ct. 394, 79 L.Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

A careful study should be made of this section and GS 53-20 (m) to determine whether GS 53-20 (m) should be modified to conform to this section.

This section does not apply to national banks.

Editor's Note. — The number of this section was assigned by the Revisor of Statutes, as Session Laws 1995, c. 232, s. 2 had renumbered this section as 25-4-216.

PART 3.

COLLECTION OF ITEMS: PAYOR BANKS.

§ 25-4-301. Deferred posting; recovery of payment by return of items; time of dishonor; return of items by payor bank.

(a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it:

(1) Returns the item; or

(2) Sends written notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a) of this section.

(c) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) As to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) In all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions. (1899, c. 733, s. 137; Rev., s. 2287; C.S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The term "deferred posting" appears in the caption of Section 4-301. This refers to the practice permitted by statute in most of the states before the UCC under which a payor bank receives items on one day but does not post the items to the customer's account until the next day. Items dishonored were then returned after the posting on the day after receipt. Under Section 4-301 the concept of "deferred posting" merely allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. With respect to checks Regulation CC Section 229.30(c) extends the midnight deadline under the UCC under certain circumstances. See the Commentary to Regulation CC Section 229.38(d) on the relationship between the UCC and Regulation CC on settlement.

2. The function of this section is to provide the circumstances under which a payor bank that has made timely settlement for an item may return the item and revoke the settlement so that it may recover any settlement made. These circumstances are: (1) the item must be a demand item other than a documentary draft; (2) the item must be presented otherwise than for immediate payment over the counter; and (3) the payor bank must return the item (or give notice if the item is unavailable for return) before its midnight deadline and before it has paid the item. With respect to checks, see Regulation CC Section 229.31(f) on notice in lieu of return and Regulation CC Section 229.33 as to the different requirement of notice of nonpayment. An instance of when an item may be unavailable for return arises under a collecting bank check retention plan under which presentment is made by a presentment notice and the item is retained by the collecting bank. Subsection 4-215(a)(2) [25-4-213(a)(2)] provides that final payment occurs if the payor bank has settled for an item without a right to revoke the settlement under statute, clearing-house rule or agreement. In any case in which Section 4-301(a) is applicable, the payor bank has a right to revoke the settlement by statute; therefore, Section 4-215(a)(2) [25-4-213(a)(2)] is inoperable, and the settlement is provisional.

Hence, if the settlement is not over the counter and the payor bank settles in a manner that does not constitute final payment, the payor bank can revoke the settlement by returning the item before its midnight deadline.

3. The relationship of Section 4-301(a) to final settlement and final payment under Section 4-215 [25-4-213] is illustrated by the following case. Depositary Bank sends by mail an item to Payor Bank with instructions to settle by remitting a teller's check drawn on a bank in the city where Depositary Bank is located. Payor Bank sends the teller's check on the day the item was presented. Having made timely settlement, under the deferred posting provisions of Section 4-301(a), Payor Bank may revoke that settlement by returning the item before its midnight deadline. If it fails to return the item before its midnight deadline, it has finally paid the item if the bank on which the teller's check was drawn honors the check. But if the teller's check is dishonored there has been no final settlement under Section 4-213(c) [25-4-213(c)] and no final payment under Section 4-215(b) [25-4-213(b)]. Since the Payor Bank has neither paid the item nor made timely return, it is accountable for the item under Section 4-302(a).

4. The time limits for action imposed by subsection (a) are adopted by subsection (b) for cases in which the payor bank is also the depositary bank, but in this case the requirement of a settlement on the day of receipt is omitted.

5. Subsection (c) fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3-503.

6. Subsection (d) leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned." For definition of "sent" as used in paragraphs (1) and (2) see Section 1-201(38). Obviously the subsection assumes that the item has not been "finally paid" under Section 4-215(a) [25-4-213(a)]. If it has been, this provision has no operation.

7. The fact that an item has been paid under proposed Section 4-215 [25-4-213] does not preclude the payor bank from asserting rights of restitution or revocation under Section 3-418. *National Savings and Trust Co. v. Park Corp.*, 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), is the correct interpretation of the present law on this issue.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

The only known statute in North Carolina relating to the several subjects of this section was GS 25-144, which had some bearing on deferred posting.

"Midnight deadline" is defined in GS 25-4-104.

Subsection (1) [now (a)]: This subsection states the general rule that lets a payor bank which makes a settlement of a demand item on the day the item was received to *revoke* the settlement by its midnight deadline.

Subsection (2) [now (b)]: This subsection applies the same rule to a payor-*depositary* bank, except it omits the requirement of a settlement on the day of receipt.

This section must be read in conjunction with GS 25-4-302, which states the consequences of a late return.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Applied in North Carolina Nat'l Bank v. Harwell, 38 N.C. App. 190, 247 S.E.2d 720 (1978).

Cited in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-302. Payor bank's responsibility for late return of item.

(a) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(1) A demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(2) Any other properly payable item unless within the time allowed for acceptance or payment of that item, the bank either accepts or pays the item or returns it and accompanying documents.

(b) The liability of a payor bank to pay an item pursuant to subsection (a) of this section is subject to defenses based on breach of a presentment warranty (G.S. 25-4-208) [25-4-207.1] or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank. (1899, c. 733, s. 137; Rev., s. 2287; C.S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a)(1) continues the former law distinguishing between cases in which the payor bank is not also the depositary bank and those in which the payor bank is also the depositary bank ("on us" items). For "on us" items the payor bank is accountable if it retains the item beyond its midnight deadline without settling for it. If the payor bank is not the depositary bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. It may avoid accountability either by settling for the item on the day of receipt and returning the item before its midnight deadline under Section 4-301 or by returning the item on the day of receipt. This rule is consistent with the deferred posting practice authorized by Section 4-301 which allows the payor bank to make provisional settlement for an item on the day of receipt and to revoke that settlement by returning the item on the next day. With respect to checks, Regulation CC Section 229.36(d) provides that settlements between banks for forward collection of checks are final when made. See the Commentary on that provision for its effect on the UCC.

2. If the settlement given by the payor bank does not become final, there has been no payment under Section 4-215(b) [25-4-213(b)], and the payor bank giving the failed settlement is accountable under subsection (a)(1) of Section 4-302. For instance, the payor bank makes provisional settlement by sending a teller's check that is dishonored. In such a case settlement is not final under Section 4-213(c) [25-4-211(c)] and no payment occurs under Section 4-215(b) [25-4-213(b)]. Payor bank is accountable on the item. The general principle is that unless settlement provides the presenting bank with usable funds, settlement has failed and the payor bank is accountable for the amount of the item.

3. Subsection (b) is an elaboration of the deleted introductory language of former Section 4-302: "In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of Section 4-207), settlement effected or the like ...." A payor bank can defend an action against it based on accountability by showing that the item contained a forged indorsement or a fraudulent alteration. Subsection (b) drops the ambiguous "or the like" language and provides that the payor bank may also raise the defense of fraud. Decisions that hold an accountable bank's liability to be "absolute" are rejected. A payor bank that makes a late return of an item should not be liable to a defrauder operating a check kiting scheme. In *Bank of Leumi Trust Co. v. Bally's Park Place Inc.,* 528 F.Supp. 349 (S.D.N.Y. 1981), and *American National Bank v. Foodbasket,* 497 P.2d 546 (Wyo. 1972), banks that were accountable under Section 4-302 for missing their midnight deadline were successful in defending against parties who initiated collection knowing that the check would not be paid. The "settlement effected" language is deleted as unnecessary. If a payor bank is accountable for an item it is liable to pay it. If it has made final payment for an item, it is no longer accountable for the item.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (a) [now (a)(1)]: This subsection prescribes the time in which a payor bank must *act* on a demand item other than a *documentary draft.*

Subsection (b) [now (a)(2)]: This covers all other items.

In either case, if the payor bank does not act promptly it is accountable for the amount of the item. Compare Branch Bank & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961), dealing with duty of a collecting bank that is *not* a payor bank. Held — The *payor's* bank is not liable as a constructive acceptor when it delays returning a draft; but court implies on p. 222 that bank might be liable for negligence. The two dissenting justices would adhere to the "time honored maxim among bankers . . . 'Never let the sun set on a Cash Item.'"

For demand items other than documentary drafts, a comparison of this section with GS 25-4-301 shows that:

(1) GS 25-4-301 (1) and (2) [now (a) and (b)] emphasize the time for *revocation of* prompt settlement made by midnight of the day of receipt.

(2) GS 25-4-302 (b) [now (a)(2)] emphasizes *promptness in making an original settlement on the day of receipt* even though the prompt settlement may be later revoked by the "midnight deadline."

Thus, it appears that under both GS 25-4-301 (1) [now (a)] and 25-4-302 (b) [now (a)(2)], a bank is liable for failure to "settle" for an item by midnight of the *day it is received.* This provision helps to minimize the "float period" by demanding "day received settlement," but then the deferred posting relief of GS 25-4-301 steps in to give until the "midnight deadline" to *revoke* a previous conditional settlement.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

§ 25-4-303. When items subject to notice, stop-payment order, legal process, or setoff; order in which items may be charged or certified.

(a) Any knowledge, notice, or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend, or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(1) The bank accepts or certifies the item;

(2) The bank pays the item in cash;

(3) The bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement;

(4) The bank becomes accountable for the amount of the item under G.S. 25-4-302 dealing with the payor bank's responsibility for late return of item; or

(5) With respect to checks, a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(b) Subject to subsection (a) of this section, items may be accepted, paid, certified or charged to the indicated account of its customer in any order. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. While a payor bank is processing an item presented for payment, it may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or

freeze all or part of whatever balance is available to pay the item. Subsection (a) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-payment order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. With respect to the effect of the customer's bankruptcy, the bank's rights are governed by Bankruptcy Code Section 542(c) which codifies the result of *Bank of Marin v. England,* 385 U.S. 99 (1966). Section 4-405 applies to the death or incompetence of the customer.

3. Once a payor bank has accepted or certified an item or has paid the item in cash, the event has occurred that determines priorities between the item and the various legal events usually described as the "four legals." Paragraphs (1) and (2) of subsection (a) so provide. If a payor bank settles for an item presented over the counter for immediate payment by a cashier's check or teller's check which the presenting person agrees to accept, paragraph (3) of subsection (a) would control and the event determining priority has occurred. Because presentment was over the counter, Section 4-301(a) does not apply to give the payor bank the statutory right to revoke the settlement. Thus the requirements of paragraph (3) have been met unless a clearing-house rule or agreement of the parties provides otherwise.

4. In the usual case settlement for checks is by entries in bank accounts. Since the process-of-posting test has been abandoned as inappropriate for automated check collection, the determining event for priorities is a given hour on the day after the item is received. (Paragraph (5) of subsection (a).) The hour may be fixed by the bank no earlier than one hour after the opening on the next banking day after the bank received the check and no later than the close of that banking day. If an item is received after the payor bank's regular Section 4-108 [25-4-107] cutoff hour, it is treated as received the next banking day. If a bank receives an item after its regular cutoff hour on Monday and an attachment is levied at noon on Tuesday, the attachment is prior to the item if the bank had not before that hour taken the action described in paragraphs (1), (2), and (3) of subsection (a). The Commentary to Regulation CC Section 229.36(d) explains that even though settlement by a paying bank for a check is final for Regulation CC purposes, the paying bank's right to return the check before its midnight deadline under the UCC is not affected.

5. Another event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under Section 4-302 dealing with the payor bank's responsibility for late return of items." Expiration of the deadline under Section 4-302 with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-payment orders, legal process or setoff.

6. In the case of knowledge, notice, stop-payment orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the accounting department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

7. As between one item and another no priority rule is stated. This is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer's account; the possible methods of receipt; and other variables. Further, the drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302. Under subsection (b) the bank has the right to pay items for which it is itself liable ahead of those for which it is not.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This subsection indirectly gives a payor bank a reasonable time to act on any notice it receives. However, the main emphasis is on establishing a cut-off time for determining the bank's right or duty to pay an item or to charge the customer's account for the item.

See also GS 25-4-403 (customer's right to stop payment; burden of proof of loss).

PART 4.

Relationship Between Payor Bank and Its Customer.

§ 25-4-401. When bank may charge customer's account.

(a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(c) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in G.S. 25-4-403(b) for stop-payment orders, and must be received at a time and in a manner that afforded the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check described in G.S. 25-4-303. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under G.S. 25-4-402.

(d) A bank that in good faith makes payment to a holder may charge the indicated account of its customer according to:

(1) The original terms of the altered item; or

(2) The terms of the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. An item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. For an example of a payment held to violate an agreement with a customer, see *Torrance National Bank v. Enesco Federal Credit Union,* 285 P.2d 737 (Cal.App. 1955). An item drawn for more than the amount of a customer's account may be properly payable. Thus under subsection (a) a bank may charge the customer's account for an item even though payment results in an overdraft. An item containing a forged drawer's signature or forged indorsement is not properly payable. Concern has arisen whether a bank may require a customer to execute a stop-payment order when the customer notifies the bank of the loss of an unindorsed or specially indorsed check. Since such a check cannot be properly payable from the customer's account, it is inappropriate for a bank to require stop-payment order in such a case.

2. Subsection (b) adopts the view of case authority holding that if there is more than one customer who can draw on an account, the nonsigning customer is not liable for an overdraft unless that person benefits from the proceeds of the item.

3. Subsection (c) is added because the automated check collection system cannot accommodate postdated checks. A check is usually paid upon presentment without respect to the date of the check. Under the former law, if a payor bank paid a postdated check before its stated date, it could not charge the customer's account because the check was not "properly payable." Hence, the bank might have been liable for wrongfully dishonoring subsequent checks of the drawer that would have been paid had the postdated check not been prematurely paid. Under subsection (c) a customer wishing

to postdate a check must notify the payor bank of its postdating in time to allow the bank to act on the customer's notice before the bank has to commit itself to pay the check. If the bank fails to act on the customer's timely notice, it may be liable for damages for the resulting loss which may include damages for dishonor of subsequent items. This Act does not regulate fees that banks charge their customers for a notice of postdating or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. *Perdue v. Crocker National Bank,* 38 Cal.3d 913 (1985) (unconscionability); *Best v. United Bank of Oregon,* 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Section 3-407(c) states that a payor bank or drawee which pays a fraudulently altered instrument in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. Section 4-401(d) follows the rule stated in Section 3-407(c) by applying it to an altered item and allows the bank to enforce rights with respect to the altered item by charging the customer's account.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [now (a)]: This subsection expressly permits overdrafts; but a bank is *not required* to pay overdraft items.

Subsection (2) [now (d)]: This covers the amounts that may be properly charged against a customer's account. The two provisions follow the same theories found in: (a) GS 25-3-407 (3) [now (c)], which permits an HDC to collect the original tenor of an altered negotiable instrument; (b) GS 25-3-115 and 25-3-407 (3), which permit full recovery on incomplete instruments completed in excess of authority.

This section is broader in scope than the article 3 sections, because article 3 applies only to "negotiable instruments," while this section applies to any "item."

Legal Periodicals. — For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

For article, "The Basic Principle of Loss Allocation for Unauthorized Checks," see 39 Wake Forest L. Rev. 453 (2004).

CASE NOTES

Payment of any overdraft by a bank amounts to a loan to the depositor, and the amount may be recovered from the depositor. The action to recover the amount of the overdraft is based upon the implied promise which arises from the drawing of the check and the honoring of it by the bank. First-Citizens Bank & Trust Co. v. Perry, 40 N.C. App. 272, 252 S.E.2d 288 (1979).

Checks made payable to the order of one payee but indorsed by someone other than the named payee were not properly payable, and by charging the checks against a customer's account, drawee bank breached its duty to charge customer's account only for items properly payable. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997), cert. denied, 346 N.C. 280, 487 S.E.2d 548 (1997).

Under § 4-401 of the Uniform Commercial Code § 4-401, G.S. 25-4-401, a bank may only charge its customers' accounts for "properly payable" items, but if the banks cashed checks payable to a third party with either no endorsement or with only the corporations' president's endorsement, such items were not properly payable; by alleging in one of its alternative theories that the banks cashed checks payable to a third party and turned the proceeds over to the president, the corporations' complaint stated at least one viable cause of action sufficient to defeat the banks' motion to dismiss under G.S. 1A-1, N.C. R. Civ. P. 12(b)(6). Castle Worldwide, Inc. v. Southtrust Bank, 157 N.C. App. 518, 579 S.E.2d 478, 2003 N.C. App. LEXIS 730 (2003).

Cited in North Carolina Nat'l Bank v. Hammond, 298 N.C. 703, 260 S.E.2d 617 (1979).

§ 25-4-402. Bank's liability to customer for wrongful dishonor; time of determining insufficiency of account.

(a) Except as otherwise provided in this Article, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(b) A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case. This subsection does not preclude noncompensatory damages.

(c) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful. (1921, c. 4, s. 38; C.S., s. 220(m); 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) states positively what has been assumed under the original Article: that if a bank fails to honor a properly payable item it may be liable to its customer for wrongful dishonor. Under subsection (b) the payor bank's wrongful dishonor of an item gives rise to a statutory cause of action. Damages may include consequential damages. Confusion has resulted from the attempts of courts to reconcile the first and second sentences of former Section 4-402. The second sentence implied that the bank was liable for some form of damages other than those proximately caused by the dishonor if the dishonor was other than by mistake. But nothing in the section described what these noncompensatory damages might be. Some courts have held that in distinguishing between mistaken dishonors and nonmistaken dishonors, the so-called "trader" rule has been retained that allowed a "merchant or trader" to recover substantial damages for wrongful dishonor without proof of damages actually suffered. Comment 3 to former Section 4-402 indicated that this was not the intent of the drafters. White & Summers, Uniform Commercial Code, Section 18-4 (1988), states: "The negative implication is that when wrongful dishonors occur not 'through mistake' but willfully, the court may impose damages greater than 'actual damages' .... Certainly the reference to 'mistake' in the second sentence of 4-402 invites a court to adopt the relevant pre-Code distinction." Subsection (b) by deleting the reference to mistake in the second sentence precludes any inference that Section 4-402 retains the "trader" rule. Whether a bank is liable for noncompensatory damages, such as punitive damages, must be decided by Section 1-103 and Section 1-106 ("by other rule of law").

2. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in Section 4-103(e). By the same token, if a dishonor comes within this section, the measure of damages of this section applies and not another measure of damages. If the wrongful refusal of the beneficiary's bank to make funds available from a funds transfer causes the beneficiary's check to be dishonored, no specific guidance is given as to whether recovery is under this section or Article 4A. In each case this issue must be viewed in its factual context, and it was thought unwise to seek to establish certainty at the cost of fairness.

3. The second and third sentences of the subsection (b) reject decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer and leave to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

4. Banks commonly determine whether there are sufficient funds in an account to pay an

item after the close of banking hours on the day of presentment when they post debit and credit items to the account. The determination is made on the basis of credits available for withdrawal as of right or made available for withdrawal by the bank as an accommodation to its customer. When it is determined that payment of the item would overdraw the account, the item may be returned at any time before the bank's midnight deadline the following day. Before the item is returned new credits that are withdrawable as of right may have been added to the account. Subsection (c) eliminates uncertainty under Article 4 as to whether the failure to make a second determination before the item is returned on the day following presentment is a wrongful dishonor if new credits were added to the account on that day that would have covered the amount of the check.

5. Section 4-402 has been construed to preclude an action for wrongful dishonor by a plaintiff other than the bank's customer. *Loucks v. Albuquerque National Bank,* 418 P.2d 191 (N.Mex. 1966). Some courts have allowed a plaintiff other than the customer to sue when the customer is a business entity that is one and the same with the individual or individuals operating it. *Murdaugh Volkswagen, Inc. v. First National Bank,* 801 F.2d 719 (4th Cir. 1986) and *Karsh v. American City Bank,* 113 Cal.App.3d 419, 169 Cal.Rptr. 851 (1980). However, where the wrongful dishonor impugns the reputation of an operator of the business, the issue is not merely, as the court in *Koger v. East First National Bank,* 443 So.2d 141 (Fla.App. 1983), put it, one of a literal versus a liberal interpretation of Section 4-402. Rather the issue is whether the statutory cause of action in Section 4-402 displaces, in accordance with Section 1-103, any cause of action that existed at common law in a person who is not the customer whose reputation was damaged. See *Marcum v. Security Trust and Savings Co.,* 221 Ala. 419, 129 So.74 (1930). While Section 4-402 should not be interpreted to displace the latter cause of action, the section itself gives no cause of action to other than a "customer," however that definition is construed, and thus confers no cause of action on the holder of a dishonored item. *First American National Bank v. Commerce Union Bank,* 692 S.W.2d 642 (Tenn.App. 1985).

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

The last sentence of subsection (b) is added for clarity.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This section states the measure of damages for wrongful dishonor of an item. It appears that it does not change the substance of GS 53-57. There were only two North Carolina decisions on GS 53-57:

Thomas v. American Trust Co., 208 N.C. 653, 182 S.E. 136 (1935), held, when no malice is dishonor, the customer is entitled at least to nominal damages. This dictum (?) seems contrary to the wording of GS 53-57 and 25-4-402, both of which adopt an "actual damages proved" test when no malice is proved.

Woody v. First Nat'l Bank, 194 N.C. 549, 140 S.E. 150 (1927), held, if malice is proved, the depositor can recover actual or nominal damages, and also punitive damages.

§ 25-4-403. Customer's right to stop payment; burden of proof of loss.

(a) A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in G.S. 25-4-303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(b) A stop-payment order is effective for six months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for additional six-month periods by a writing given to the bank within a period during which the stop-payment order is effective.

(c) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under G.S. 25-4-402. (1929, c. 341, s. 1; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. The position taken by this section is that stopping payment or closing an account is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop or close should be borne by the banks as a cost of the business of banking.

2. Subsection (a) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3-602. The sole exception to this rule is found in Section 4-405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

3. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. If the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 4-106) [25-4-105.1] the maker may stop payment of the note. By analogy the rule extends to drawees other than banks.

4. A cashier's check or teller's check purchased by a customer whose account is debited in payment for the check is not a check drawn on the customer's account within the meaning of subsection (a); hence, a customer purchasing a cashier's check or teller's check has no right to stop payment of such a check under subsection (a). If a bank issuing a cashier's check or teller's check refuses to pay the check as an accommodation to its customer or for other reasons, its liability on the check is governed by Section 3-411. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3-411 and 4-303. The acceptance is the drawee's own engagement to pay, and it is not required to impair its credit by refusing payment for the convenience of the drawer.

5. Subsection (a) makes clear that if there is more than one person authorized to draw on a customer's account any one ofem can stop payment of any check drawn on the account or can order the account closed. Moreover, if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check. In describing the item, the customer, in the absence of a contrary agreement, must meet the standard of what information allows the bank under the technology then existing to identify the item with reasonable certainty.

6. Under subsection (b), a stop-payment order is effective after the order, whether written or oral, is received by the bank and the bank has a reasonable opportunity to act on it. If the order is written it remains in effect for six months from that time. If the order is oral it lapses after 14 days unless there is written confirmation. If there is written confirmation within the 14-day period, the six-month period dates from the giving of the oral order. A stop-payment order may be renewed any number of times by written notice given during a six-month period while a stop order is in effect. A new stop-payment order may be given after a six-month period expires, but such a notice takes effect from the date given. When a stop-payment order expires it is as though the order had never been given, and the payor bank may pay the item in good faith under Section 4-404 even though a stop-payment order had once been given.

7. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(a) if in paying the item over the stop-payment order the bank has failed to exercise ordinary care. An agreement to the contrary which is imposed upon a customer as part of a standard form contract would have to be evaluated in the light of the general obligation of good faith. Sections 1-203 and 4-104(c). The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4-407); retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop-payment order (Section 1-103); and retains common law rights, e.g., to recover money paid under a mistake under Section 3-418. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer re-

mains liable on the instrument to the holder in due course (Sections 3-305, 3-414) and the drawee, if it pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4-407. The relationship between Sections 4-403 and 4-407 is discussed in the Comments to Section 4-407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder were bringing the action.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [(a)]: This subsection gives a bank a reasonable time to act on a stop-order.

Subsection (2) [omitted from the 1995 revision]: This subsection makes an oral stop-order effective for fourteen days and a written stop-order effective for six months. This differs from GS 25-198 which (a) implied that an original oral stop-order was effective for six months and (b) stated that a renewal stop-order had to be in writing and was effective for six months.

Payment may not be stopped after acceptance of a draft or certification of a check. See GS 25-3-411 and 25-4-303.

Subsection (3) [(c)]: Payment in violation of a stop-order is improper, but under subsection (3) the customer must prove his damages.

While a bank may contract to relieve itself of liability for nonnegligently overlooking a stop-order, it may not contract away its duty to use reasonable care. Also, to prevent unjust enrichment, a bank is given subrogation rights under GS 25-4-407.

(*Note:* The section applies only to bank-drawees, but it applies to any "item." Article 3 contains no similar rule for "negotiable instruments" drawn on nonbanks, but the same right to stop payment exists apart from statute.)

Legal Periodicals. — For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

CASE NOTES

Drawer's Liability to Holder Not Discharged by Stop Order. — By acting in apt time, the drawer of a check may stop its payment, but his revocation of the bank's authority to pay the check does not discharge his liability to the payee or holder. Reeves v. Jurney, 29 N.C. App. 739, 225 S.E.2d 615, cert. denied, 290 N.C. 663, 228 S.E.2d 454 (1976).

Amount of Loss Must Be More Than Mere Debiting of Bank Account. — Where the bank pleads nonloss by the bank customer, a bank customer, in order to recover for damages caused by the bank's payment of a check contrary to a valid stop payment order, must show some loss other than the mere debiting of his bank account in the amount of the check. Mitchell v. Republic Bank & Trust Co., 35 N.C. App. 101, 239 S.E.2d 867 (1978).

Burden of Proof. — A prima facie case of loss is established by the customer when he shows that the bank paid a check contrary to a valid stop payment order. Then the bank, exercising its subrogation rights created by G.S. 25-4-407, has the burden of coming forward and presenting evidence of an absence of actual loss sustained by the customer. When the bank meets the burden of coming forward, the customer must sustain the ultimate burden of proving loss. Mitchell v. Republic Bank & Trust Co., 35 N.C. App. 101, 239 S.E.2d 867 (1978).

§ 25-4-404. Bank not obligated to pay check more than six months old.

A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith. (C. S., s. 3168; 1929, c. 341, s. 3; 1965, c. 700, s. 1.)

OFFICIAL COMMENT (1991 ED.)

This section incorporates a type of statute that had been adopted in 26 jurisdictions before the Code. The time limit is set at six months because banking and commercial practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the section because they are the primary obligation of the certifying bank (Sections 3-409 and 3-413). The obligation runs directly to the holder of the check. The customer's account was presumably charged when the check was certified.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This section is similar to GS 25-194, a section added by North Carolina to the NIL. GS 25-194, however, was broader than this UCC section in that GS 25-194 applied to "a check or *other* instrument payable on demand." GS 25-4-404 applies only to checks.

§ 25-4-405. Death or incompetence of customer.

(a) A payor or collecting bank's authority to accept, pay, or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the authority to accept, pay, collect, or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(b) Even with knowledge, a bank may for ten days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.

(c) A transaction, although subject to this Article, is also subject to G.S. 41-2.1, 53-146.1, 54-109.58, and 54B-129, and in case of conflict between the provisions of this section and either of those sections, the provisions of those sections control. (1965, c. 700, s. 1; 1967, c. 24, s. 10; c. 562, s. 1; 1995, c. 232, s. 2; 1998-69, s. 10.)

OFFICIAL COMMENT (1991 ED.)

1. Subsection (a) follows existing decisions holding that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any rule that required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

2. Subsection (b) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other

items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that these checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

3. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is "colorable." But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

NORTH CAROLINA COMMENT TO THE 1995 AMENDMENT

Subsection (c), which does not appear in the Uniform Act, brings forward former G.S. 25-4-405(3) and adds cross references to G.S. 53-146.1, 54-109.58, and 54B-129.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Banking custom in North Carolina operates on the premise that a check should not be paid after death of the drawer. This custom is supported by GS 105-24, a tax section, which states that a bank should not pay over any money after the death of a customer without retaining an amount to pay inheritance taxes.

Unless GS 105-24 is amended, GS 25-4-405 (2) will have little practical meaning.

Graham v. Hoke, 219 N.C. 755, 14 S.E.2d 790 (1941), is contrary to GS 25-4-405 (2) [now (b)], holding that death of a drawer revoked any authority of a bank to pay "a cheque."

§ 25-4-406. Customer's duty to discover and report unauthorized signature or alteration.

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item.

(c) If a bank sends or makes available a statement of account or items pursuant to subsection (a) of this section, the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(d) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (c) of this section, the customer is precluded from asserting against the bank:

(1) The customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) The customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank.

(e) If subsection (d) of this section applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) of this section and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) of this section does not apply.

(f) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subsection (a) of this section) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under G.S. 25-4-208 [25-4-207.1] with respect to the unauthorized signature or alteration to which the preclusion applies. (1965, c. 700, s. 1; 1981, c. 599, s. 19; 1995, c. 232, s. 2.)

REVISED OFFICIAL COMMENT (1991 ED.)

1. Under subsection (a), if a bank that has paid a check or other item for the account of a customer makes available to the customer a statement of account showing payment of the item, the bank must either return the item to the customer or provide a description of the item sufficient to allow the customer to identify it. Under subsection (c), the customer has a duty to exercise reasonable promptness in examining the statement or the returned item to discover any unauthorized signature of the customer or any alteration and to promptly notify the bank if the customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) becomes operative only if the "bank sends or makes available a statement of account or items pursuant to subsection (a)." A bank is not under a duty to send a statement of account or the paid items to the customer; but, if it does not do so, the customer does not have any duties under subsection (c).

Under subsection (a), a statement of account must provide information "sufficient to allow the customer reasonably to identify the items paid." If the bank supplies its customer with an image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank complies with the standard of providing "sufficient information" if "the item is described by item number, amount, and date of payment." This means that the customer's duties under subsection (c) are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items. A bank does not have to return the paid items unless it has agreed with the customer to do so. Whether there is such an agreement depends upon the particular circumstances. See Section 1-201(3). If the bank elects to provide the minimum information that is "sufficient" under subsection (a) and, as a consequence, the customer could not "reasonably have discovered the unauthorized payment," there is no preclusion under subsection (d). If the customer made a record of the issued checks on the check stub or carbonized copies furnished by the bank in the checkbook, the customer should usually be able to verify the paid items shown on the statement of account and discover any unauthorized or altered checks. But there could be exceptional circumstances. For example, if a check is altered by changing the name of the payee, the customer could not normally detect the fraud unless the customer is given the paid check or the statement of account discloses the name of the payee of the altered check. If the customer could not "reasonably have discovered the unauthorized payment" under subsection (c) there would not be a preclusion under subsection (d).

The "safe harbor" provided by subsection (a) serves to permit a bank, based on the state of existing technology, to trigger the customer's duties under subsection (c) by providing a "statement of account showing payment of items" without having to return the paid items, in any case in which the bank has not agreed with the customer to return the paid items. The "safe harbor" does not, however, preclude a customer under subsection (d) from asserting its unauthorized signature or an alteration against a bank in those circumstances in which under subsection (c) the customer should not "reasonably have discovered the unauthorized payment." Whether the customer has failed to comply with its duties under subsection (c) is determined on a case-by-case basis.

The provision in subsection (a) that a statement of account contains "sufficient information if the item is described by item number, amount, and date of payment" is based upon the existing state of technology. This information was chosen because it can be obtained by the bank's computer from the check's MICR line without examination of the items involved. The other two items of information that the customer would normally want to know -- the name of the payee and the date of the item -- cannot currently be obtained from the MICR line. The safe harbor rule is important in determining the feasibility of payor or collecting bank check retention plans. A customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the checks supplied by the bank in the checkbook, will usually have sufficient information to identify the items on the basis of item number, amount, and date of payment. But customers who do not utilize these record-keeping methods may not. The policy decision is that accommodating customers who do not keep adequate records is not as desirable as accommodating customers who keep more careful records. This policy results in less cost to the check collection system and thus to all customers of the system. It is expected that technological advances such as image processing may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendations for an amendment revising the safe harbor requirements in the light of those advances.

2. Subsection (d) states the consequences of a failure by the customer to perform its duty under subsection (c) to report an alteration or the customer's unauthorized signature. Subsection (d)(1) applies to the unauthorized payment of the item to which the duty to report under subsection (c) applies. If the bank proves that the customer "should reasonably have discovered the unauthorized payment" (See Comment 1) and did not notify the bank, the customer is precluded from asserting against the bank the alteration or the customer's unauthorized signature if the bank proves that it suffered a loss as a result of the failure of the customer to perform its subsection (c) duty. Subsection (d)(2) applies to cases in which the customer fails to report an unauthorized signature or alteration with respect to an item in breach of the subsection (c) duty (See Comment 1) and the bank subsequently pays other items of the customer with respect to which there is an alteration or unauthorized signature of the customer and the same wrongdoer is involved. If the payment of the subsequent items occurred after the customer has had a reasonable time (not exceeding 30 days) to report with respect to the first item and before the bank received notice of the unauthorized signature or alteration of the first item, the customer is precluded from asserting the alteration or unauthorized signature with respect to the subsequent items.

If the customer is precluded in a single or multiple item unauthorized payment situation under subsection (d), but the customer proves that the bank failed to exercise ordinary care in paying the item or items and that the failure substantially contributed to the loss, subsection (e) provides a comparative negligence test for allocating loss between the customer and the bank. Subsection (e) also states that, if the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

Subsection (d)(2) changes former subsection (2)(b) by adopting a 30-day period in place of a 14-day period. Although the 14-day period may have been sufficient when the original version of Article 4 was drafted in the 1950s, given the much greater volume of checks at the time of the revision, a longer period was viewed as more appropriate. The rule of subsection (d)(2) follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care (See Comment 1) in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subsection (d)(2) is prescribed, and to avoid dispute a specific time limit, 30 days, is designated for cases to which the subsection applies. These considerations are not present if there are no losses resulting from the payment of additional items. In these circumstances, a reasonable period for the customer to comply with its duties under subsection (c) would depend on the circumstances (Section 1-204(2)) and the subsection (d)(2) time limit should not be imported by analogy into subsection (c).

3. Subsection (b) applies if the items are not returned to the customer. Check retention plans may include a simple payor bank check retention plan or the kind of check retention plan that would be authorized by a truncation agreement in which a collecting bank or the payee may retain the items. Even after agreeing to a check retention plan, a customer may need to see one or more checks for litigation or other purposes. The customer's request for the check may always be made to the payor bank. Under subsection (b) retaining banks may destroy items but must maintain the capacity to furnish legible copies for seven years. A legible copy may include an image of an item. This Act does not define the length of the reasonable period of time for a bank to provide the check or copy of the check. What is reasonable depends on the capacity of the bank and the needs of the customer. This Act does not specify sanctions for failure to retain or furnish the items or legible copies; this is left to other laws regulating banks. See Comment 3 to Section 4-101. Moreover, this Act does not regulate fees that banks charge their customers for furnishing items or copies or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. *Perdue v. Crocker National Bank,* 38 Cal.3d 913 (1985) (unconscionability); *Best v. United Bank of Oregon,* 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Subsection (e) replaces former subsection (3) and poses a modified comparative negligence test for determining liability. See the discussion on this point in the Comments to Sections 3-404, 3-405, and 3-406. The term "good faith" is defined in Section 3-103(a)(4) as including "observance of reasonable commercial standards of fair dealing." The connotation of this standard is fairness and not absence of negligence.

The term "ordinary care" used in subsection (e) is defined in Section 3-103(a)(7), made applicable to Article 4 by Section 4-104(c), to provide that sight examination by a payor bank is not required if its procedure is reasonable and is commonly followed by other comparable banks in the area. The case law is divided on this issue. The definition of "ordinary care" in Section 3-103 rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law. The effect of the definition of "ordinary care" on Section 4-406 is only to provide that in the small percentage of cases in which a customer's failure to examine its statement or returned items has led to loss under subsection (d) a bank should not have to share that loss solely because it has adopted an automated collection or payment procedure in order to deal with the great volume of items at a lower cost to all customers.

5. Several changes are made in former Section 4-406(5). First, former subsection (5) is deleted and its substance is made applicable only to the one-year notice preclusion in former subsection (4) (subsection (f)). Thus if a drawer has not notified the payor bank of an unauthorized check or material alteration within the one-year period, the payor bank may not choose to recredit the drawer's account and pass the loss to the collecting banks on the theory of breach of warranty. Second, the reference in former subsection (4) to unauthorized indorsements is deleted. Section 4-406 imposes no duties on the drawer to look for unauthorized indorsements. Section 4-111 sets out a statute of limitations allowing a customer a three-year period to seek a credit to an account improperly charged by payment of an item bearing an unauthorized indorsement. Third, subsection (c) is added to Section 4-208 [25-4-207.1] to assure that if a depositary bank is sued for breach of a presentment warranty, it can defend by showing that the drawer is precluded by Section 3-406 or Section 4-406(c) and (d).

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (1) [see now (a) to (c)]: This subsection takes the place of GS 53-76, which also places a general duty of due care on a depositor to inspect vouchers and promptly report any errors.

Subsection (2) [now (d)]: Subsection (2)(b) changes the rule of GS 53-52 on the time within which a depositor must report his own unauthorized signature: GS 53-52 uses an automatic 60-day test, i.e., (a) for forgeries reported within 60 days of day the customer receives his voucher, he can recover; but (b) for forgeries not reported within the 60 days, he cannot recover.

When there has been a series of unauthorized signatures or alterations by the same person, subsection (2)(b) has a special rule. It provides, in effect, that a depositor cannot recover payments made by the bank during a period of time commencing with 14 days after the customer has first received one such item and ending with the time that the bank receives notice. These rules apply only if the customer has been negligent under subsection (1).

Subsection (3) [see now (e)]: A depositor has three years to report an unauthorized *indorsement.* A bank may not show that its customer is "precluded" if the customer establishes lack of ordinary care on the part of the bank.

Subsection (4) [now (f)]: As in subsection (2) (b), this subsection (4) changes the rule of GS 53-52 on the time within which a depositor must report his own unauthorized signature. (See subsection (2) (b) above.)

Even within the one-year, three-year, and 14-day periods, the depositor must still use "reasonable care and promptness."

The decision of Schwabenton v. Security Nat'l Bank, 251 N.C. 655, 111 S.E.2d 856 (1960), is changed by GS 25-4-406.

Subsection (5): This subsection prevents a bank that can make itself whole against its customer from recovering from collecting banks or other prior parties.

GS 53-75 (statement of account from bank to depositor deemed final adjustment if not objected to within five years) will still cover irregularities other than unauthorized signatures and alterations.

Legal Periodicals. — For note discussing direct drawer suits against collecting parties for loss arising from unauthorized checks, see 17 Wake Forest L. Rev. 844 (1981).

For survey of 1981 commercial law, see 60 N.C.L. Rev. 1238 (1982).

CASE NOTES

Applicability of Notice Provision. — This section makes provision for notifying a bank of unauthorized checks within certain time periods after bank statements have been received in order to hold the bank liable and this is a standard of reasonable conduct which should also apply in regard to notifying other payors pursuant to G.S. 25-3-406. Hartford Accident & Indem. Co. v. Dean's Shop-Rite, Inc., 48 N.C. App. 615, 269 S.E.2d 282 (1980).

As to the effect of subsection (2)(b) of this section on former § 53-52, see Burnette v. First Citizens Bank & Trust Co., 48 N.C. App. 585, 269 S.E.2d 317 (1980).

Any item paid by a bank in good faith on an unauthorized signature, even though payment is made from an account different from the one in which the bank customer was negligent in failing to report an unauthorized signature, would be governed by subsection (2)(b) of this section, which precludes a customer's recovery from a bank on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding 14 calendar days and before the bank receives notification from the customer of any such unauthorized signature. Burnette v. First Citizens Bank & Trust Co., 48 N.C. App. 585, 269 S.E.2d 317 (1980).

Action for Recovery of Losses Not Barred. — In an action to recover $13,500 withdrawn from plaintiff's savings account at defendant bank without her authorization, plaintiff was not barred by this section from establishing her right to recover her losses from defendant since evidence that plaintiff, a 95-year-old woman, examined her bank statements during 1976-1977 to see if they showed she had the right amount in the account, that she did not detect that any numbers had been erased or substituted, and that she noticed white tape on the statement but thought the bank was responsible for the tape, raised a jury question as to whether plaintiff failed to exercise reasonable care and promptness in examining the statements to discover her unauthorized signature. Burnette v. First Citizens Bank & Trust Co., 48 N.C. App. 585, 269 S.E.2d 317 (1980).

Applied in First Fed. Sav. & Loan Ass'n v. Branch Banking & Trust Co., 282 N.C. 44, 191 S.E.2d 683 (1972); Ind-Com Elec. Co. v. First Union Nat'l Bank, 58 N.C. App. 215, 293 S.E.2d 215 (1982).

§ 25-4-407. Payor bank's right to subrogation on improper payment.

If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights:

(1) Of any holder in due course on the item against the drawer or maker;

(2) Of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(3) Of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. Section 4-403 states that a stop-payment order or an order to close an account is binding on a bank. If a bank pays an item over such an order it is prima facie liable, but under subsection (c) of Section 4-403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-payment order is that the drawer or maker suffered no loss because it would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and paragraph (1) of this section state this rule.

2. Paragraph (2) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods it is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Paragraph (3) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop-payment order or right to recover money paid under a mistake.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This section is closely related to GS 25-4-403 on stop-orders.

Basically, the section is intended to prevent unjust enrichment, and it accomplishes this by allowing a payor bank that has made a wrongful payment to be subrogated to the rights of various other parties against others.

Perhaps the most important right of a payor is to have the rights of any prior HDC against the drawer-customer in cases where the bank has failed to obey a stop-order.

Legal Periodicals. — For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

PART 5.

Collection of Documentary Drafts.

§ 25-4-501. Handling of documentary drafts; duty to send for presentment and to notify customer of dishonor.

A bank that takes a documentary draft for collection shall present or send the draft and accompanying documents for presentment, and upon learning that the draft has not been paid or accepted in due course, shall seasonably notify its customer of the fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

This section states the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104. The duty stated exists even if the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned the customer should know it promptly.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Notice that the bank has a duty to notify its customer even when the bank has bought the dishonored draft. This is because the customer will normally be commercially interested in the fact of dishonor even though the customer is not to be held liable on the instrument.

See Branch Bank & Trust Co. v. Bank of Washington, 255 N.C. 205, 120 S.E.2d 830 (1961).

§ 25-4-502. Presentment of "on arrival" drafts.

If a draft or the relevant instructions require presentment "on arrival," "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival' but also drafts forwarded with instructions to present "on arrival." The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Notice the duty to notify of a refusal to pay even though the refusal does not amount to a dishonor.

§ 25-4-503. Responsibility of presenting bank for documents and goods; report of reasons for dishonor; referee in case of need.

Unless otherwise instructed and except as provided in Article 5, a bank presenting a documentary draft:

(1) Must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and

(2) Upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or, if the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor, and must request instructions.

However, the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for those expenses. (1899, c. 733, s. 131; Rev., s. 2281; C.S., s. 3113; 1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

1. This section states the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with Section 2-514 on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5-109 through 5-114.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

Subsection (a) [now (1)]: This subsection varies the duty to deliver the accompanying documents according to whether the draft is payable more or not more than three days after presentment. This subsection should be read in conjunction with GS 25-2-514 on when documents are deliverable on acceptance and when only on payment.

Subsection (b) [now (2)]: This gives a bank two choices after dishonor: (1) Ask advice of any designated "referee in case of need"; or (2) contact the transferor.

Article 5 controls when a draft is drawn under letter of credit. See GS 25-5-109 through 25-5-114.

§ 25-4-504. Privilege of presenting bank to deal with goods; security interest for expenses.

(a) A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(b) For its reasonable expenses incurred by action under subsection (a) of this section, the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien. (1965, c. 700, s. 1; 1995, c. 232, s. 2.)

OFFICIAL COMMENT (1991 ED.)

The section gives the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

NORTH CAROLINA COMMENT

This Comment is to the original version of this section.

This section gives protection to a bank that has reasonably dealt with goods. Expenditures may be realized by the bank as if foreclosing an unpaid seller's lien under GS 25-2-706.

ARTICLE 4A.

Funds Transfers.

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PART 1.

SUBJECT MATTER AND DEFINITIONS.

§ 25-4A-101. Short title.

This Article may be cited as Uniform Commercial Code—Funds Transfers. (1993, c. 157, s. 1.)

Legal Periodicals. — For article, "The Basic Principle of Loss Allocation for Unauthorized Checks," see 39 Wake Forest L. Rev. 453 (2004).

§ 25-4A-102. Subject matter.

Except as otherwise provided in G.S. 25-4A-108, this Article applies to funds transfers defined in G.S. 25-4A-104. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

Article 4A governs a specialized method of payment referred to in the Article as a funds transfer but also commonly referred to in the commercial community as a wholesale wire transfer. A funds transfer is made by means of one or more payment orders. The scope of Article 4A is determined by the definitions of "payment order" and "funds transfer" found in Section 4A-103 and Section 4A-104.

The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes. Before this Article was drafted there was no comprehensive body of law — statutory or judicial — that defined the juridical nature of a funds transfer or the rights and obligations flowing from payment orders. Judicial authority with respect to funds transfers is sparse, undeveloped and not uniform. Judges have had to resolve disputes by referring to general principles of common law or equity, or they have sought guidance in statutes such as Article 4 which are applicable to other payment methods. But attempts to define rights and obligations in funds transfers by general principles or by analogy to rights and obligations in negotiable instrument law or the law of check collection have not been satisfactory.

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

Funds transfers involve competing interests — those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

§ 25-4A-103. Payment order — definitions.

(a) In this Article:

(1) "Payment order" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) The instruction does not state a condition of payment to the beneficiary other than time of payment,

(ii) The receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) The instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(2) "Beneficiary" means the person to be paid by the beneficiary's bank.

(3) "Beneficiary's bank" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(4) "Receiving bank" means the bank to which the sender's instruction is addressed.

(5) "Sender" means the person giving the instruction to the receiving bank.

(b) If an instruction complying with subsection (a)(1) is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-104.

§ 25-4A-104. Funds transfer — definitions.

In this Article:

(a) "Funds transfer" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(b) "Intermediary bank" means a receiving bank other than the originator's bank or the beneficiary's bank.

(c) "Originator" means the sender of the first payment order in a funds transfer.

(d) "Originator's bank" means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary") or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to pay the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A-103 and "Funds transfer" stated in Section 4A-104. These definitions, other related definitions, and the scope of Article 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y's account in Bank A. Bank A carries out X's instruction by making a credit of $1,000,000 to Y's account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A-103(a)(1) and (c). X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A-103(a)(5) and (a)(4). Y is the "beneficiary" of the payment order and Bank A is the "beneficiary's bank." Section 4A-103(a)(2) and (a)(3). When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A-209(b)(1). When Bank A accepted the order it incurred an obligation to Y to pay the amount of the order. Section 4A-404(a). When Bank A accepted X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(b). Payment from X to Bank A would normally be made by a debit to X's account in Bank A. Section 4A-403(a)(3). At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A-406(a). Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y's account. Section 4A-405(a). The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A-104(a). In this case only one payment order was involved in the funds transfer. A one-payment-order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank's debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A-104(c). Bank A is the "originator's bank" in the funds transfer as well as the beneficiary's bank. Section 4A-104(d).

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y's account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X's order by instructing Bank B to pay $1,000,000 to Y's account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X's order. Section 4A-301(a). In the funds transfer, X is the originator, Bank A is the originator's bank, and Bank B is the beneficiary's bank. When Bank A executed X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(c). When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A-404(a)) and Bank A incurs an obligation to pay Bank B. Section 4A-402(b). Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A-406(a). In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X's payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y's account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving Bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y's account in Bank B. With respect to Bank C's payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator's bank, Bank B is the beneficiary's bank, and Bank C is an "intermediary bank." Section 4A-104(b). In some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator's payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator's bank.

2. "Payment order" is defined in Section 4A-103(a)(1) as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A-103(a)(4). "Bank" is defined in Section 4A-105(a)(2). The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short-term credit granted by the receiving bank to the sender of the payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer-based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1). Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York

bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107), payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a)(1) of Section 4A-103 is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X's instruction given to Bank A, Bank A will be reimbursed by debiting X's account or otherwise receiving payment from X. With respect to Bank A's instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A. In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor's bank account by issuing an instruction to pay to the debtor's bank. If the debtor's bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder's bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder's account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary's bank to pay the parent from the subsidiary's account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation's account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation's account in Bank A for the purpose of transferring funds into Corporation's account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer's account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wire-transfer business as a "draw-down transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B's warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A-103 is to exclude from Article 4A payments made by check or

credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the creditcard slip is to be presented is contained in the check or creditcard slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor's bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator's Bank to pay $10,000 to the account of Beneficiary in Beneficiary's Bank. Since the amount of Originator's payment order is small, if Originator's Bank and Beneficiary's Bank do not have an account relationship, Originator's Bank may execute Originator's order by issuing a teller's check payable to Beneficiary's Bank for $10,000 along with instructions to credit Beneficiary's account in that amount. The instruction to Beneficiary's Bank to credit Beneficiary's account is a payment order. The check is the means by which Originator's Bank pays its obligation as sender of the payment order. The instruction of Originator's Bank to Beneficiary's Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary's Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary's Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator's Bank pays its obligation under G.S. 4A-402(b) to Beneficiary's Bank and the means by which the instruction to Beneficiary's Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender. Transmission may be by letter or other written communication, oral communication or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT or an automated clearing house.

§ 25-4A-105. Other definitions.

(a) In this Article:

(1) "Authorized account" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(2) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.

(3) "Customer" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(4) "Funds-transfer business day" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(5) "Funds-transfer system" means a wire transfer network, automated clearinghouse, or other communication system of a clearinghouse or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(6) Repealed by Session Laws 2006-112, s. 15, effective October 1, 2006.

(7) "Prove" with respect to a fact means to meet the burden of establishing the fact (G.S. 25-1-201(b)(8)).

(b) Other definitions applying to this Article and the sections in which they appear are:

"Acceptance"	G.S. 25-4A-209
"Beneficiary"	G.S. 25-4A-103
"Beneficiary's bank"	G.S. 25-4A-103
"Executed"	G.S. 25-4A-301
"Execution date"	G.S. 25-4A-301
"Funds transfer"	G.S. 25-4A-104
"Funds-transfer system rule"	G.S. 25-4A-501
"Intermediary bank"	G.S. 25-4A-104
"Originator"	G.S. 25-4A-104
"Originator's bank"	G.S. 25-4A-104
"Payment by beneficiary's bank to beneficiary"	G.S. 25-4A-405
"Payment by originator to beneficiary"	G.S. 25-4A-406
"Payment by sender to receiving bank"	G.S. 25-4A-403
"Payment date"	G.S. 25-4A-401
"Payment order"	G.S. 25-4A-103
"Receiving bank"	G.S. 25-4A-103
"Security procedure"	G.S. 25-4A-201
"Sender"	G.S. 25-4A-103.

(c) The following definitions in Article 4 apply to this Article:

"Clearing house"	G.S. 25-4-104
"Item"	G.S. 25-4-104
"Suspends payments"	G.S. 25-4-104.

(d) In addition, Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article. (1993, c. 157, s. 1; 2006-112, ss. 15, 16.)

OFFICIAL COMMENT

1. The definition of "bank" in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries the definition also covers foreign banks. The definition also includes Federal Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A-107.

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4-104(1)(c) cannot be used to describe when a bank is open for funds transfer business. Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank's computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A-206. The Comment to that section and the

Comment to Section 4A-107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A-501, may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article 1 as well as principles of construction and interpretation stated in that Article. Included is Section 1-103. The last paragraph of the Comment to Section 4A-102 is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 15 and 16, effective October 1, 2006, repealed subdivision (a)(6) and substituted "(G.S. 25-1-201(b)(8))" for "(G.S. 25-1-201(8))" in subdivision (a)(7).

§ 25-4A-106. Time payment order is received.

(a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a notice stated in G.S. 25-1-202. A receiving bank may fix a cutoff time or times on a funds-transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cutoff times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cutoff time may apply to senders generally or different cutoff times may apply to different senders or categories of payment orders. If a payment order or communication cancelling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cutoff time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this Article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this Article. (1993, c. 157, s. 1; 2006-112, s. 17.)

OFFICIAL COMMENT

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-201(27). Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 17, effective October 1, 2006, substituted "G.S. 25-1-202" for "G.S. 25-1-201(27)" in the first sentence of subsection (a).

§ 25-4A-107. Federal reserve regulations and operating circulars.

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay $1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of $1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of $1,000,000 to the account of Reserve Bank X and an equal credit to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1). Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d). Reserve Bank X, an intermediary bank under Section 4A-104(b), executes Bank A's order by sending a payment order to Reserve Bank Y instructing that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment order to Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A may execute Originator's order by means of Fedwire which simultaneously transfers $1,000,000 from Bank A to Bank B and carries a message instructing Bank B to pay $1,000,000 to the account of Y. The Fedwire transfer is carried out as described in the previous paragraph, except that the beneficiary of the funds transfer is Beneficiary rather than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account it will also instruct Bank B to pay to the account of Beneficiary. The instruction is a payment order to Bank B which is the beneficiary's bank. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account Bank B receives payment of the payment order issued to it by Reserve Bank Y. Section 4A-403(a)(1). The payment order is automatically accepted by Bank B at the time it receives the payment order of Reserve Bank Y. Section 4A-209(b)(2). At the time of acceptance by Bank B payment by Originator to Beneficiary also occurs. Thus, in a Fedwire transfer, payment to the beneficiary's bank, acceptance by the beneficiary's bank and payment by the originator to the beneficiary all occur simultaneously by operation of law at the time the payment order to the beneficiary's bank is received.

If originator orders payment to the account of Beneficiary in Bank C rather than Bank B, the analysis is somewhat modified. Bank A may not have any relationship with Bank C and may not be able to make payment directly to Bank C. In that case, Bank A could send a Fedwire instructing Bank B to instruct Bank C to pay Beneficiary. The analysis is the same as the previous case except that Bank B is an intermediary bank and Bank C is the beneficiary's bank.

2. A funds transfer can also be made through a Federal Reserve Bank in an automated clearing house transaction. In a typical case, Originator instructs Originator's Bank to pay to the account of Beneficiary in Beneficiary's Bank. Originator's instruction to pay a particular beneficiary is transmitted to Originator's Bank along with many other instructions for payment to other beneficiaries by many different beneficiary's banks. All of these instructions are contained in a magnetic tape or other electronic device. Transmission of instructions to the various beneficiary's banks requires that Originator's instructions be processed and repackaged with instructions of other originators so that all instructions to a particular beneficiary's bank

are transmitted together to that bank. The repackaging is done in processing centers usually referred to as automated clearing houses. Automated clearing houses are operated either by Federal Reserve Banks or by other associations of banks. If Originator's Bank chooses to execute Originator's instructions by transmitting them to a Federal Reserve Bank for processing by the Federal Reserve Bank, the transmission to the Federal Reserve Bank results in the issuance of payment orders by Originator's Bank to the Federal Reserve Bank, which is an intermediary bank. Processing by the Federal Reserve Bank will result in the issuance of payment orders by the Federal Reserve Bank to Beneficiary's Bank as well as payment orders to other beneficiary's banks making payments to carry out Originator's instructions.

3. Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 4A-107 states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 4A to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 4A-107 treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

§ 25-4A-108. Exclusion of consumer transactions governed by federal law.

This Article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. § 1693 et seq.) as amended from time to time. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

The Electronic Fund Transfer Act of 1978 is a federal statute that covers a wide variety of electronic funds transfers involving consumers. The types of transfers covered by the federal statute are essentially different from the wholesale wire transfers that are the primary focus of Article 4A. Section 4A-108 excludes a funds transfer from Article 4A if any part of the transfer is covered by the federal law. Existing procedures designed to comply with federal law will not be affected by Article 4A. The effect of Section 4A-108 is to make Article 4A and EFTA mutually exclusive. For example, if a funds transfer is to a consumer account in the beneficiary's bank and the funds transfer is made in part by use of Fedwire and in part by means of an automated clearing house, EFTA applies to the ACH part of the transfer but not to the Fedwire part. Under Section 4A-108, Article 4A does not apply to any part of the transfer. However, in the absence of any law to govern the part of the funds transfer that is not subject to EFTA, a court might apply appropriate principles from Article 4A by analogy.

PART 2.

Issue and Acceptance of Payment Order.

§ 25-4A-201. Security procedure.

"Security procedure" means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, call-back procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

A large percentage of payment orders and communications amending or cancelling payment orders are transmitted electronically and it is standard practice to use security procedures that are designed to assure the authenticity of the message. Security procedures can also be used to detect error in the content of messages or to detect payment orders that are transmitted by mistake as in the case of multiple transmission of the same payment order. Security procedures might also apply to communications that are transmitted by telephone or in writing. Section 4A-201 defines these security procedures. The definition of security procedure limits the term of a procedure "established by agreement of a customer and a receiving bank." The term does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders. The question of whether loss that may result from the transmission of a spurious or erroneous payment order will be borne by the receiving bank or the sender or purported sender is affected by whether a security procedure was or was not in effect and whether there was or was not compliance with the procedure. Security procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205, which deals with erroneous payment orders.

§ 25-4A-202. Authorized and verified payment orders.

(a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term "sender" in this Article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (a), or it is effective as the order of the customer under subsection (b).

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in G.S. 25-4A-203(a)(1), rights and obligations arising under this section or G.S. 25-4A-203 may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-203.

§ 25-4A-203. Unenforceability of certain verified payment orders.

(a) If an accepted payment order is not, under G.S. 25-4A-202(a), an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to G.S. 25-4A-202(b), the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Some person will always be identified as the sender of a payment order. Acceptance of the order by the receiving bank is based on a belief by the bank that the order was authorized by the person identified as the sender. If the receiving bank is the beneficiary's bank acceptance means that the receiving bank is obliged to pay the beneficiary. If the receiving bank is not the beneficiary's bank, acceptance means that the receiving bank has executed the sender's order and is obliged to pay the bank that accepted the order issued in execution of the sender's order. In either case the receiving bank may suffer a loss unless it is entitled to enforce payment of the payment order that it accepted. If the person identified as the sender of the order refuses to pay on the ground that the order was not authorized by that person, what are the rights of the receiving bank? In the absence of a statute or agreement that specifically addresses the issue, the question usually will be resolved by the law of agency. In some cases, the law of agency works well. For example, suppose the receiving bank executes a payment order given by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the receiving bank acts solely on the basis of the letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and the officer was authorized to act for the corporation in the issuance of payment orders, or some other agency doctrine such as apparent authority or estoppel causes the corporation to be bound. Estoppel can be illustrated by the following example. Suppose P is aware that A, who is unauthorized to act for P, has fraudulently misrepresented to T that A is authorized to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision. Restatement,

Second, Agency G.S. 8B. Other equitable principles such as subrogation or restitution might also allow a receiving bank to recover with respect to an unauthorized payment order that it accepted. In Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep. Serv. 2d 171 (D. Md. 1986), a joint venturer not authorized to order payments from the account of the joint venture, ordered a funds transfer from the account. The transfer paid a bona fide debt of the joint venture. Although the transfer was unauthorized the court refused to require recredit of the account because the joint venture suffered no loss. The result can be rationalized on the basis of subrogation of the receiving bank to the right of the beneficiary of the funds transfer to receive the payment from the joint venture.

But in most cases these legal principles give the receiving bank very little protection in the case of an authorized payment order. Cases like those just discussed are not typical of the way that most payment orders are transmitted and accepted, and such cases are likely to become even less common. Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201.

In a very large percentage of cases covered by Article 4A, transmission of the payment order is made electronically. The receiving bank may be required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. There is no way of determining the identity or the authority of the person who caused the message to be sent. The receiving bank is not relying on the authority of any particular person to act for the purported sender. The case is not comparable to payment of a check by the drawee bank on the basis of a signature that is forged. Rather, the receiving bank relies on a security procedure pursuant to which the authenticity of the message can be "tested" by various devices which are designed to provide certainty that the message is that of the sender identified in the payment order. In the wire transfer business the concept of "authorized" is different from that found in agency law. In that business a payment order is treated as the order of the person in whose name it is issued if it is properly tested pursuant to a security procedure and the order passes the test.

Section 4A-202 reflects the reality of the wire transfer business. A person in whose name a payment order is issued is considered to be the sender of the order if the order is "authorized" as stated in subsection (a) or if the order is "verified" pursuant to a security procedure in compliance with subsection (b). If subsection (b) does not apply, the question of whether the customer is responsible for the order is determined by the law of agency. The issue is one of actual or apparent authority of the person who caused the order to be issued in the name of the customer. In some cases the law of agency might allow the customer to be bound by an unauthorized order if conduct of the customer can be used to find an estoppel against the customer to deny that the order was unauthorized. If the customer is bound by the order under any of these agency doctrines, subsection (a) treats the order as authorized and thus the customer is deemed to be the sender of the order. In most cases, however, subsection (b) will apply. In that event there is no need to make an agency law analysis to determine authority. Under Section 4A-202, the issue of liability of the purported sender of the payment order will be determined by agency law only if the receiving bank did not comply with subsection (b).

2. The scope of Section 4A-202 can be illustrated by the following cases.

> *Case #1.* A payment order purporting to be that of Customer is received by Receiving Bank but the order was fraudulently transmitted by a person who had no authority to act for Customer.
>
> *Case #2.* An authentic payment order was sent by Customer, but before the order was received by Receiving Bank the order was fraudulently altered by an unauthorized person to change the beneficiary.
>
> *Case #3.* An authentic payment order was received by Receiving Bank, but before the order was executed by Receiving Bank a person who had no authority to act for Customer fraudulently sent a communication purporting to amend the order by changing the beneficiary.

In each case Receiving Bank acted on the fraudulent communication by accepting the payment order. These cases are all essentially similar and they are treated identically by Section 4A-202. In each case Receiving Bank acted on a communication that it thought was authorized by Customer when in fact the communication was fraudulent. No distinction is made between Case #1 in which Customer took no part at all in the transaction and Case #2 and Case #3 in which an authentic order was fraudulently altered or amended by an unauthorized person. If subsection (b) does not apply, each case is governed by subsection (a). If there are no additional facts on which an estoppel might be found, Customer is not responsible in Case #1 for the fraudulently issued payment order, in Case #2 for the fraudulent alteration or in Case #3 for the fraudulent amendment. Thus, in each case Customer is not liable to pay the order and Receiving Bank takes the loss. The only remedy of Receiving Bank is to seek recovery from the person who received payment as beneficiary of the fraudulent order. If there was verification in compliance with subsection (b), Customer will take the loss unless Section 4A-203 applies.

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to "test" a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and "in compliance with the security procedure." If the fraud was not detected because the bank's employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not required to follow an instruction that violates a written agreement. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 apply.

Subsection (b)(i) assures that the interests of the customer will be protected by providing an incentive to a bank to make available to the customer a security procedure that is commercially reasonable. If a commercially reasonable security procedure is not made available to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking practice may require that security procedures be utilized in virtually all cases except for those in which personal contact between the customer and the bank eliminates the possibility of an unauthorized order. The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine what security procedures can be used and are in the best position to evaluate the efficacy of the procedures offered to customers to combat fraud. The burden on the customer is to supervise its employees to assure compliance with the security procedure and to safeguard confidential security information and access to transmitting facilities so that the security procedure cannot be breached.

4. The principal issue that is likely to arise in litigation involving subsection (b) is whether the security procedure in effect when a fraudulent payment order was accepted was commercially reasonable. The concept of what is commercially reasonable in a given case is flexible. Verification entails labor and equipment costs that can vary greatly depending upon the degree of security that is sought. A customer that transmits very large numbers of payment orders in very large amounts may desire and may reasonably expect to be provided with state-of-the-art procedures that provide maximum security. But the expense involved may make use of a state-of-the-art procedure infeasible for a customer that normally transmits payment orders infrequently or in relatively low amounts. Another variable is the type of receiving bank. It is reasonable to require large money center banks to make available state-of-the-art security procedures. On the other hand, the same requirement may not be reasonable for a small country bank. A receiving bank might have several security procedures that are designed to meet the varying needs of different customers. The type of payment order is another variable. For example, in a wholesale wire transfer, each payment order is normally transmitted electronically and individually. A testing procedure will be individually applied to each payment order. In funds transfers to be made by means of an automated clearing house many payment orders are incorporated into an electronic device such as a magnetic tape that is physically delivered. Testing of the individual payment

orders is not feasible. Thus, a different kind of security procedure must be adopted to take into account the different mode of transmission.

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk. It is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

5. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an unauthorized payment order is accepted by the receiving bank after verification by the bank in compliance with a commercially reasonable security procedure. An exception to this result is provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a payment order if the customer can prove that the fraud was not committed by a person described in that subsection. Breach of a commercially reasonable security procedure requires that the person committing the fraud have knowledge of how the procedure works and knowledge of codes, identifying devices, and the like. That person may also need access to transmitting facilities through an access device or other software in order to breach the security procedure. This confidential information must be obtained either from a source controlled by the customer or from a source controlled by the receiving bank. If the customer can prove that the person committing the fraud did not obtain the confidential information from an agent or former agent of the customer or from a source controlled by the customer, the loss is shifted to the bank. "Prove" is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this kind of case there will always be a criminal investigation as well as an internal investigation of the bank to determine the probable explanation for the breach of security. Because a funds transfer fraud usually will involve a very large amount of money, both the criminal investigation and the internal investigation are likely to be thorough. In some cases there may be an investigation by bank examiners as well. Frequently, these investigations will develop evidence of who is at fault and the cause of the loss. The customer will have access to evidence developed in these investigations and that evidence can be used by the customer in meeting its burden of proof.

6. The effect of Section 4A-202(b) may also be changed by an agreement meeting the requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of the risk of loss with respect to unauthorized payment orders even if all of the requirements of Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all of the risk of loss with respect to unauthorized payment orders or the customer and bank may agree that losses from unauthorized payment orders are to be divided as provided in the agreement.

7. In a large majority of cases the sender of a payment order is a bank. In many cases in which there is a bank sender, both the sender and the receiving bank will be members of a funds transfer system over which the payment order is transmitted. Since Section 4A-202(f) does not prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a rule of the funds transfer system can determine how loss due to an unauthorized payment order from a participating bank to another participating bank is to be allocated. A funds transfer system rule, however, cannot change the rights of a customer that is not a

participating bank. G.S. 4A-501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.

§ 25-4A-204. Refund of payment and duty of customer to report with respect to unauthorized payment order.

(a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under G.S. 25-4A-202, or (ii) not enforceable, in whole or in part, against the customer under G.S. 25-4A-203, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) of this section may be fixed by agreement as stated in G.S. 25-1-302(b), but the obligation of a receiving bank to refund payment as stated in subsection (a) of this section may not otherwise be varied by agreement. (1993, c. 157, s. 1; 2006-112, s. 18.)

OFFICIAL COMMENT

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A-204 applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2), that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A-203(a)(1) agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer's account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A-204 states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A-204 is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding 90 days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly unauthorized, the customer should normally discover it in far less than 90 days. If a $1,000,000 payment order was authorized but the name of the beneficiary was fraudulently changed, a much longer period may be necessary to discover the fraud.

But in any event, if the customer delays more than 90 days the customer's duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer's account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A-506. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 18, effective October 1, 2006, in subsection (b), substituted "G.S. 25-1-302(b)" for "G.S. 25-1-204(1)", and inserted "of this section" in two places.

§ 25-4A-205. Erroneous payment orders.

(a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to G.S. 25-4A-206 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (2) and (3).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of subsection (a), the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in clause (ii) of subsection (a), the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in subsection (a) is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding 90 days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. *Case #1.* The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. *Case #2.* The error is in the amount of the order. For example, Sender intends to wire $1,000 to Beneficiary. Through error, the payment order instructs payment of $1,000,000. *Case #3.* A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 as "a procedure established by agreement of a customer and a receiving bank for the purpose of * * * detecting error * * *," Section 4A-205 does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a $1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a)(1) applies, the position of the receiving bank is comparable to that of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. However, failure of the sender to timely report the error is covered by Section 4A-205(b) rather than by Section 4A-304 which applies only to erroneous execution under Section 4A-303. A receiving bank to which the risk of loss is shifted by subsection (a)(1) or (2) is entitled to recover the amount erroneously paid to the beneficiary to the extent allowed by the law of mistake and restitution. Rights of the receiving bank against the beneficiary are similar to those of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. Those rights are discussed in Comment 2 to Section 4A-303.

2. A security procedure established for the purpose of detecting error is not effective unless both sender and receiving bank comply with the procedure. Thus, the bank undertakes a duty of complying with the procedure for the benefit of the sender. This duty is recognized in subsection (a)(1). The loss with respect to the sender's error is shifted to the bank if the bank fails to comply with the procedure and the sender (or an agent under Section 4A-206) does comply. Although the customer may have been negligent in transmitting the erroneous payment order, the loss is put on the bank on a last-clear-chance theory. A similar analysis applies to subsection (b). If the loss with respect to an error is shifted to the receiving bank and the sender is notified by the bank that the erroneous payment order was accepted, the sender has a duty to exercise ordinary care to discover the error and notify the bank of the relevant

facts within a reasonable time not exceeding 90 days. If the bank can prove that the sender failed in this duty it is entitled to compensation for the loss incurred as a result of the failure. Whether the bank is entitled to recover from the sender depends upon whether the failure to give timely notice would have made any difference. If the bank could not have recovered from the beneficiary that received payment under the erroneous payment order even if timely notice had been given, the sender's failure to notify did not cause any loss of the bank.

3. Section 4A-205 is subject to variation by agreement under Section 4A-501. Thus, if a receiving bank and its customer have agreed to a security procedure for detection of error, the liability of the receiving bank for failing to detect an error of the customer as provided in Section 4A-205 may be varied as provided in an agreement of the bank and the customer.

§ 25-4A-206. Transmission of payment order through funds-transfer or other communication system.

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the Federal Reserve Banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. A payment order may be issued to a receiving bank directly by delivery of a writing or electronic device or by an oral or electronic communication. If an agent of the sender is employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted by the agent on the basis of agency law. Section 4A-206 is an application of that principle to cases in which a funds transfer or communication system acts as an intermediary in transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for the purpose of transmitting payment orders and related messages for the sender. Section 4A-206 deals with error by the intermediary.

2. Transmission by an automated clearing house of an association of banks other than the Federal Reserve Banks is an example of a transaction covered by Section 4A-206. Suppose Originator orders Originator's Bank to cause a large number of payments to be made to many accounts in banks in various parts of the country. These payment orders are electronically transmitted to Originator's Bank and stored in an electronic device that is held by Originator's Bank. Or, transmission of the various payment orders is made by delivery to Originator's Bank of an electronic device containing the instruction to the bank. In either case the terms of the various payment orders by Originator are determined by the information contained in the electronic device. In order to execute the various orders, the information in the electronic device must be processed. For example, if some of the orders are for payments to accounts in Bank X and some to accounts in Bank Y, Originator's Bank will execute these orders of Originator by issuing a series of payment orders to Bank X covering all payments to accounts in that bank, and by issuing a series of payment orders to Bank Y covering all payments to accounts in that bank. The orders to Bank X may be transmitted together by means of an electronic device, and those to Bank Y may be included in another electronic device. Typically, this processing is done by an automated clearing house acting for a group of banks including Originator's Bank. The automated clearing house is a funds transfer system. Section 4A-105(a)(5). Originator's Bank delivers Originator's electronic device or transmits the information contained in the device to the funds transfer system for processing into payment orders of Originator's Bank to the appropriate beneficiary's banks. The processing may result in an erroneous payment order. Originator's Bank, by use of Originator's electronic device, may have given information to the funds transfer system instructing payment of $100,000 to an account in Bank X, but because of human error or an equipment mal-

function the processing may have converted that instruction into an instruction to Bank X to make a payment of $1,000,000. Under Section 4A-206, Originator's Bank issued a payment order for $1,000,000 to Bank X when the erroneous information was sent to Bank X. Originator's Bank is responsible for the error of the automated clearing house. The liability of the funds transfer system that made the error is not governed by Article 4A. It is left to the law of contract, a funds transfer system rule, or other applicable law.

In the hypothetical case just discussed, if the automated clearing house is operated by a Federal Reserve Bank, the analysis is different. Section 4A-206 does not apply. Originator's Bank will execute Originator's payment orders by delivery or transmission of the electronic information to the Federal Reserve Bank for processing. The result is that Originator's Bank has issued payment orders to the Federal Reserve Bank which, in this case, is acting as an intermediary bank. When the Federal Reserve Bank has processed the information given to it by Originator's Bank it will issue payment orders to the various beneficiary's banks. If the processing results in an erroneous payment order, the Federal Reserve Bank has erroneously executed the payment order of Originator's Bank and the case is governed by Section 4A-303.

§ 25-4A-207. Misdescription of beneficiary.

(a) Subject to subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in subsection (c), if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in subsection (b) is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by subsection (b)(1), the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by subsection (b)(1), if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) If the originator is obliged to pay its payment order as stated in subsection (c), the originator has the right to recover.

(2) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts. Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c), a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

2. Subsection (b), which takes precedence over subsection (a), deals with the problem of payment orders in which the description of the beneficiary does not allow identification of the beneficiary because the beneficiary is described by name and by an identifying number or an account number and the name and number refer to different persons. A very large percentage of payment orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account. The processing of the order by the beneficiary's bank and the crediting of the beneficiary's account are done by use of the identifying or bank account number without human reading of the payment order itself. The process is comparable to that used in automated payment of checks. The standard format, however, may also allow the inclusion of the name of the beneficiary and other information which can be useful to the beneficiary's bank and the beneficiary but which plays no part in the process of payment. If the beneficiary's bank has both the account number and name of the beneficiary supplied by the originator of the funds transfer, it is possible for the beneficiary's bank to determine whether the name and number refer to the same person, but if a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost. Manual handling of payment orders is both expensive and subject to human error. If payment orders can be handled on an automated basis there are substantial economies of operation and the possibility of clerical error is reduced. Subsection (b) allows banks to utilize automated processing by allowing banks to act on the basis of the number without regard to the name if the bank does not know that the name and number refer to different persons. "Know" is defined in Section 1-201(25) to mean actual knowledge, and Section 1-201(27) states rules for determining when an organization has knowledge of information received by the organization. The time of payment is the pertinent time at which knowledge or lack of knowledge must be determined.

Although the clear trend is for beneficiary's banks to process payment orders by automated means, Section 4A-207 is not limited to cases in which processing is done by automated means. A bank that processes by semi-automated means or even manually may rely on number as stated in Section 4A-207.

In cases covered by subsection (b) the erroneous identification would in virtually all cases be the identifying or bank account number. In the typical case the error is made by the originator of the funds transfer. The originator should know the name of the person who is to receive payment and can further identify that person by an address that would normally be known to the originator. It is not unlikely, however, that the originator may not be sure whether the identifying or account number refers to the person the originator intends to pay. Subsection (b)(1) deals with the typical case in which the beneficiary's bank pays on the basis of the account number and is not aware at the time of payment that the named beneficiary is not the holder of the account which was paid. In some cases the false number will be the result of error by the originator. In other cases fraud is involved. For example, Doe is the holder of shares in Mutual Fund. Thief, impersonating Doe, requests redemption of the shares and directs Mutual Fund to wire the redemption proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund originates a funds transfer by issuing a payment order to Originator's Bank to make the payment to Doe's account #12345 in Beneficiary's Bank. Originator's Bank executes the order by issuing a conforming payment order to Beneficiary's Bank which makes payment to account #12345. That account is the account of Roe rather than Doe. Roe might be a person acting in concert with Thief or Roe might be an innocent third party. Assume that Roe is a gem merchant that agreed to sell gems to Thief who agreed to wire the purchase price to Roe's account in Beneficiary's Bank. Roe believed that the credit to Roe's account was a transfer of funds from Thief and released the gems to Thief in good faith in reliance on the payment. The case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. See Securities Fund Services, Inc. v. American National Bank, 542 F.Supp. 323 (N.D.Ill.1982) and Bradford Trust Co. v. Texas American Bank, 790 F.2d 407 (5th Cir. 1986). Section 4A-207 resolves the issue.

If Beneficiary's Bank did not know about the conflict between the name and number, subsection (b)(1) applies. Beneficiary's Bank has no duty to determine whether there is a conflict and it may rely on the number as the proper identification of the beneficiary of the order. When it accepts the order, it is entitled to payment from Originator's Bank. Section 4A-402(b). On the other hand, if Beneficiary's Bank knew about the conflict between the name and number and nevertheless paid Roe, subsection (b)(2) applies. Under that provision, acceptance of the payment order of Originator's Bank did not occur because there is no beneficiary of that order. Since acceptance did not occur Originator's Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b). Similarly, Mutual Fund is excused from its obligation to pay Originator's Bank. Section 4A-402(c). Thus, Beneficiary's Bank takes the loss. Its only cause of action is against Thief. Roe is not obliged to return the payment to the beneficiary's bank because Roe received the payment in good faith and for value. Article 4A makes irrelevant the issue of whether Mutual Fund was or was not negligent in issuing its payment order.

3. Normally, subsection (b)(1) will apply to the hypothetical case discussed in Comment 2. Beneficiary's Bank will pay on the basis of the number without knowledge of the conflict. In that case subsection (c) places the loss on either Mutual Fund or Originator's Bank. It is not unfair to assign the loss to Mutual Fund because it is the person who dealt with the impostor and it supplied the wrong account number. It could have avoided the loss if it had not used an account number that it was not sure was that of Doe. Mutual Fund, however, may not have been aware of the risk involved in giving both name and number. Subsection (c) is designed to protect the originator, Mutual Fund, in this case. Under that subsection, the originator is responsible for the inconsistent description of the beneficiary if it had notice that the order might be paid by the beneficiary's bank on the basis of the number. If the originator is a bank, the originator always has that responsibility. The rationale is that any bank should know how payment orders are processed and paid. If the originator is not a bank, the originator's bank must prove that its customer, the originator, had notice. Notice can be proved by any admissible evidence, but the bank can always prove notice by providing the customer with a written statement of the required information and obtaining the customer's signature to the statement. That statement will then apply to any payment order accepted by the bank thereafter. The information need not be supplied more than once.

In the hypothetical case if Originator's Bank made the disclosure stated in the last sentence of subsection (c)(2), Mutual Fund must pay Originator's Bank. Under subsection (d)(1), Mutual Fund has an action to recover from Roe if recovery from Roe is permitted by the law governing mistake and restitution. Under the assumed facts Roe should be entitled to keep the money as a person who took it in good faith and for value since it was taken as payment for the gems. In that case, Mutual Fund's only remedy is against Thief. If Roe was not acting in good faith, Roe has to return the money to Mutual Fund. If Originator's Bank does not prove that Mutual Fund had notice as stated in subsection (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the risk of loss falls on Originator's Bank whose remedy is against Roe or Thief as stated above. Subsection (d)(2).

§ 25-4A-208. Misdescription of intermediary bank or beneficiary's bank.

(a) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in G.S. 25-4A-302(a)(1). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section addresses an issue similar to that addressed by Section 4A-207. Because of automation in the processing of payment orders, a payment order may identify the beneficiary's bank or an intermediary bank by an identifying number. The bank identified by number might or might not also be identified by name. The following two cases illustrate Section 4A-208(a) and (b):

Case #1. Originator's payment order to Originator's Bank identifies the beneficiary's bank as Bank A and instructs payment to Account #12345 in that bank. Originator's Bank executes Originator's order by issuing a payment order to Intermediary Bank. In the payment order of Originator's Bank the beneficiary's bank is identified as Bank A but is also identified by number, #67890. The identifying number refers to Bank B rather than Bank A. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank, in executing the order, will rely on the identifying number and will issue a payment order to Bank B rather than Bank A. If there is an Account #12345 in Bank B, the payment order of Intermediary Bank would normally be accepted and payment would be made to a person not intended by Originator. In this case, Section 4A-208(b)(1) puts the risk of loss on Originator's Bank. Intermediary Bank may rely on the number #67890 as the proper identification of the beneficiary's bank. Intermediary Bank has properly executed the payment order of Originator's Bank. By using the wrong number to describe the beneficiary's bank, Originator's Bank has improperly executed Originator's payment order because the payment order of Originator's Bank provides for payment to the wrong beneficiary, the holder of Account #12345 in Bank B rather than the holder of Account #12345 in Bank A. Section 4A-302(a)(1) and Section 4A-303(c). Originator's Bank is not entitled to payment from Originator but is required to pay Intermediary Bank. Section 4A-303(c) and Section 4A-402(c). Intermediary Bank is also entitled to compensation for any loss and expenses resulting from the error by Originator's Bank.

If there is no Account #12345 in Bank B, the result is that there is no beneficiary of the payment order issued by Originator's Bank and the funds transfer will not be completed. Originator's Bank is not entitled to payment from Originator and Intermediary Bank is not entitled to payment from Originator's Bank. Section 4A-402(c). Since Originator's Bank improperly executed Originator's payment order it may be liable for damages under Section 4A-305. As stated above, Intermediary Bank is entitled to compensation for loss and expenses resulting from the error by Originator's Bank.

Case #2. Suppose the same payment order by Originator to Originator's Bank as in Case #1. In executing the payment order Originator's Bank issues a payment order to Intermediary Bank in which the beneficiary's bank is identified only by number, #67890. That number does not refer to Bank A. Rather, it identifies a person that is not a bank. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank will rely on the number #67890 to identify the beneficiary's bank. Intermediary Bank has no duty to determine whether the number identifies a bank. The funds transfer cannot be completed in this case because no bank is identified as the beneficiary's bank. Subsection (a) puts the risk of loss on Originator's Bank. Originator's Bank is not entitled to payment from Originator. Section 4A-402(c). Originator's Bank has improperly executed Originator's payment order and may be liable for damages under Section 4A-305. Originator's Bank is obliged to compensate Intermediary Bank for loss and expenses resulting from the error by Originator's Bank.

Subsection (a) also applies if #67890 identifies a bank, but the bank is not Bank A. Intermediary Bank may rely on the number as the proper identification of the beneficiary's bank. If the bank to which Intermediary Bank sends its payment order accepts the order, Intermediary Bank is entitled to payment from Originator's Bank, but Originator's Bank is not entitled to payment from Originator. The analysis is similar to that in Case #1.

2. Subsection (b)(2) of Section 4A-208 addresses cases in which an erroneous identification of a beneficiary's bank or intermediary bank by name and number is made in a payment order of a sender that is not a bank. Suppose Originator issues a payment order to Originator's Bank that instructs that bank to use an intermediary bank identified as Bank A and by an identifying number, #67890. The identifying number refers to Bank B. Originator intended to identify Bank A as intermediary bank. If Originator's Bank relied on the number and issued a payment order to Bank B the rights of Originator's Bank depend upon whether the proof of notice stated in subsection (b)(2) is made by Originator's Bank. If proof is made, Originator's Bank's rights are governed by subsection (b)(1) of Section 4A-208. Originator's Bank is not liable for breach of Section 4A-302(a)(1) and is entitled to compensation from Originator for any loss and expenses resulting from Originator's error. If notice is not proved, Originator's Bank may not rely on the number in executing Originator's payment order. Since Originator's Bank does not get the benefit of subsection (b)(1) in that case, Originator's Bank improperly executed Originator's payment order and is in breach of the obligation stated in Section 4A-302(a)(1). If notice is not given, Originator's Bank can rely on the name if it is not aware of the conflict in name and number. Subsection (b)(3).

3. Although the principal purpose of Section 4A-208 is to accommodate automated processing of payment orders, Section 4A-208 applies regardless of whether processing is done by automation, semi-automated means or manually.

§ 25-4A-209. Acceptance of payment order.

(a) Subject to subsection (d), a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to subsections (c) and (d), a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) When the bank (i) pays the beneficiary as stated in G.S. 25-4A-405(a) or G.S. 25-4A-405(b), or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(2) When the bank receives payment of the entire amount of the sender's order pursuant to G.S. 25-4A-403(a)(1) or G.S. 25-4A-403(a)(2); or

(3) The opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (b)(2) or (b)(3) if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently cancelled pursuant to G.S. 25-4A-211(b), the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section treats the sender's payment order as a request by the sender to the receiving bank to execute or pay the order and that request can be accepted or rejected by the receiving bank. Section 4A-209 defines when acceptance occurs. Section 4A-210 covers rejection. Acceptance of the payment order imposes an obligation on the receiving bank to the sender if the receiving bank is not the beneficiary's bank, or to the beneficiary if the receiving bank is the beneficiary's bank. These obligations are stated in Section 4A-302 and Section 4A-404.

2. Acceptance by a receiving bank other than the beneficiary's bank is defined in Section 4A-209(a). That subsection states the only way that a bank other than the beneficiary's bank can accept a payment order. A payment order to a bank other than the beneficiary's bank is, in effect, a request that the receiving bank execute the sender's order by issuing a payment order to the beneficiary's bank or to an intermediary bank. Normally, acceptance occurs at the time of execution, but there is an exception stated in subsection (d) and discussed in Comment 9. Execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's order. Section 4A-301(a). In some cases the payment order issued by the receiving bank may not conform to the sender's order. For example, the receiving bank might make a mistake in the amount of its order, or the order might be issued to the wrong beneficiary's bank or for the benefit of the wrong beneficiary. In all of these cases there is acceptance of the sender's order by the bank when the receiving bank issues its order intended to carry out the sender's order, even though the bank's payment order does not in fact carry out the instruction of the sender. Improper execution of the sender's order may lead to liability to the sender for damages or it may mean that the sender is not obliged to pay its payment order. These matters are covered in Section 4A-303, Section 4A-305, and Section 4A-402.

3. A receiving bank has no duty to accept a payment order unless the bank makes an agreement, either before or after issuance of the payment order, to accept it, or acceptance is required by a funds transfer system rule. If the bank makes such an agreement it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates the agreement. In

many cases a bank will enter into an agreement with its customer to govern the rights and obligations of the parties with respect to payment orders issued to the bank by the customer or, in cases in which the sender is also a bank, there may be a funds transfer system rule that governs the obligations of a receiving bank with respect to payment orders transmitted over the system. Such agreements or rules can specify the circumstances under which a receiving bank is obliged to execute a payment order and can define the extent of liability of the receiving bank for breach of the agreement or rule. Section 4A-305(d) states the liability for breach of an agreement to execute a payment order.

4. In the case of a payment order issued to the beneficiary's bank, acceptance is defined in Section 4A-209(b). The function of a beneficiary's bank that receives a payment order is different from that of a receiving bank that receives a payment order for execution. In the typical case, the beneficiary's bank simply receives payment from the sender of the order, credits the account of the beneficiary and notifies the beneficiary of the credit. Acceptance by the beneficiary's bank does not create any obligation to the sender. Acceptance by the beneficiary's bank means that the bank is liable to the beneficiary for the amount of the order. Section 4A-404(a). There are three ways in which the beneficiary's bank can accept a payment order which are described in the following comments.

5. Under Section 4A-209(b)(1), the beneficiary's bank can accept a payment order by paying the beneficiary. In the normal case of crediting an account of the beneficiary, payment occurs when the beneficiary is given notice of the right to withdraw the credit, the credit is applied to a debt of the beneficiary, or "funds with respect to the order" are otherwise made available to the beneficiary. Section 4A-405(a). The quoted phrase covers cases in which funds are made available to the beneficiary as a result of receipt of a payment order for the benefit of the beneficiary but the release of funds is not expressed as payment of the order. For example, the beneficiary's bank might express a release of funds equal to the amount of the order as a "loan" that will be automatically repaid when the beneficiary's bank receives payment by the sender of the order. If the release of funds is designated as a loan pursuant to a routine practice of the bank, the release is conditional payment of the order rather than a loan, particularly if normal incidents of a loan such as the signing of a loan agreement or note and the payment of interest are not present. Such a release of funds is payment to the beneficiary under Section 4A-405(a). Under Section 4A-405(c) the bank cannot recover the money from the beneficiary if the bank does not receive payment from the sender of the payment order that it accepted. Exceptions to this rule are stated in G.S. 4A-405(d) and (e). The beneficiary's bank may also accept by notifying the beneficiary that the order has been received. "Notifies" is defined in Section 1-201(26). In some cases a beneficiary's bank will receive a payment order during the day but settlement of the sender's obligation to pay the order will not occur until the end of the day. If the beneficiary's bank wants to defer incurring liability to the beneficiary until the beneficiary's bank receives payment, it can do so. The beneficiary's bank incurs no liability to the beneficiary with respect to a payment order that it receives until it accepts the order. If the bank does not accept pursuant to subsection (b)(1), acceptance does not occur until the end of the day when the beneficiary's bank receives settlement. If the sender settles, the payment order will be accepted under subsection (b)(2) and the funds will be released to the beneficiary the next morning. If the sender doesn't settle, no acceptance occurs. In either case the beneficiary's bank suffers no loss.

6. In most cases the beneficiary's bank will receive a payment order from another bank. If the sender is a bank and the beneficiary's bank receives payment from the sender by final settlement through the Federal Reserve System or a funds transfer system (Section 4A-403(a)(1)) or, less commonly, through credit to an account of the beneficiary's bank with the sender or another bank (Section 4A-403(a)(2)), acceptance by the beneficiary's bank occurs at the time payment is made. Section 4A-209(b)(2). A minor exception to this rule is stated in Section 4A-209(c). Section 4A-209(b)(2) results in automatic acceptance of payment orders issued to a beneficiary's bank by means of Fedwire because the Federal Reserve account of the beneficiary's bank is credited and final payment is made to that bank when the payment order is received.

Subsection (b)(2) would also apply to cases in which the beneficiary's bank mistakenly pays a person who is not the beneficiary of the payment order issued to the beneficiary's bank. For example, suppose the payment order provides for immediate payment to Account #12345. The beneficiary's bank erroneously credits Account #12346 and notifies the holder of that account of the credit. No acceptance occurs in this case under subsection (b)(1) because the beneficiary of the order has not been paid or notified. The holder of Account #12345 is the beneficiary of the order issued to the beneficiary's bank. But acceptance will normally occur if the beneficiary's bank takes no other action, because the bank will normally receive settlement with respect to the payment order. At that time the bank has accepted because the sender paid its payment order. The bank is liable to pay the holder of Account #12345. The bank has paid the holder of Account #12346 by mistake, and has a right to recover the payment if the credit is withdrawn, to the extent provided in the law governing mistake and restitution.

7. Subsection (b)(3) covers cases of inaction by the beneficiary's bank. It applies whether or not the sender is a bank and covers a case in which the sender and the beneficiary both have accounts with the receiving bank and payment will be made by debiting the account of the sender and crediting the account of the beneficiary. Subsection (b)(3) is similar to subsection (b)(2) in that it bases acceptance by the beneficiary's bank on payment by the sender. Payment by the sender is effected by a debit to the sender's account if the account balance is sufficient to cover the amount of the order. On the payment date (Section 4A-401) of the order the beneficiary's bank will normally credit the beneficiary's account and notify the beneficiary of receipt of the order if it is satisfied that the sender's account balance covers the order or is willing to give credit to the sender. In some cases, however, the bank may not be willing to give credit to the sender and it may not be possible for the bank to determine until the end of the day on the payment date whether there are sufficient good funds in the sender's account. There may be various transactions during the day involving funds going into and out of the account. Some of these transactions may occur late in the day or after the close of the banking day. To accommodate this situation, subsection (b)(3) provides that the status of the account is determined at the opening of the next funds transfer business day of the beneficiary's bank after the payment date of the order. If the sender's account balance is sufficient to cover the order, the beneficiary's bank has a source of payment and the result in almost all cases is that the bank accepts the order at that time if it did not previously accept under subsection (b)(1). In rare cases, a bank may want to avoid acceptance under subsection (b)(3) by rejecting the order as discussed in Comment 8.

8. Section 4A-209 is based on a general principle that a receiving bank is not obliged to accept a payment order unless it has agreed or is bound by a funds transfer system rule to do so. Thus, provision is made to allow the receiving bank to prevent acceptance of the order. This principle is consistently followed if the receiving bank is not the beneficiary's bank. If the receiving bank is not the beneficiary's bank, acceptance is in the control of the receiving bank because it occurs only if the order is executed. But in the case of the beneficiary's bank acceptance can occur by passive receipt of payment under subsection (b)(2) or (3). In the case of a payment made by Fedwire acceptance cannot be prevented. In other cases the beneficiary's bank can prevent acceptance by giving notice of rejection to the sender before payment occurs under Section 4A-403(a)(1) or (2). A minor exception to the ability of the beneficiary's bank to reject is stated in Section 4A-502(c)(3).

Under subsection (b)(3) acceptance occurs at the opening of the next funds transfer business day of the beneficiary's bank following the payment date unless the bank rejected the order before that time or it rejects within one hour after that time. In some cases the sender and the beneficiary's bank may not be in the same time zone or the beginning of the business day of the sender and the funds transfer business day of the beneficiary's bank may not coincide. For example, the sender may be located in California and the beneficiary's bank in New York. Since in most cases notice of rejection would be communicated electronically or by telephone, it might not be feasible for the bank to give notice before one hour after the opening of the funds transfer business day in New York because at that hour, the sender's business day may not have started in California. For that reason, there are alternative deadlines stated in subsection (b)(3). In the case stated, the bank acts in time if it gives notice within one hour after the opening of the business day of the sender. But if the notice of rejection is received by the sender after the payment date, the bank is obliged to pay interest to the sender if the sender's account does not bear interest. In that case the bank had the use of funds of the sender that the sender could reasonably assume would be used to pay the beneficiary. The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the payment date the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

9. Subsection (d) applies only to a payment order by the originator of a funds transfer to the originator's bank and it refers to the following situation. On April 1, Originator instructs Bank A to make a payment on April 15 to the account of Beneficiary in Bank B. By mistake, on April 1, Bank A executes Originator's payment order by issuing a payment order to Bank B instructing immediate payment to Beneficiary. Bank B credited Beneficiary's account and immediately released the funds to Beneficiary. Under subsection (d) no acceptance by Bank A occurred on April 1 when Originator's payment order was executed because acceptance cannot occur before the execution date which in this case would be April 15 or shortly before that date. Section 4A-301(b). Under Section 4A-402(c), Originator is not obliged to pay Bank A until the order is accepted and that can't occur until the execution date. But Bank A is required to pay Bank B when Bank B accepted Bank A's order on April 1. Unless Originator and Beneficiary are the same person, in almost all cases Originator is paying a debt

owed to Beneficiary and early payment does not injure Originator because Originator does not have to pay Bank A until the execution date. Section 4A-402(c). Bank A takes the interest loss. But suppose that on April 3, Originator concludes that no debt was owed to Beneficiary or that the debt was less than the amount of the payment order. Under Section 4A-211(b) Originator can cancel its payment order if Bank A has not accepted. If early execution of Originator's payment order is acceptance, Originator can suffer a loss because cancellation after acceptance is not possible without the consent of Bank A and Bank B. Section 4A-211(c). If Originator has to pay Bank A, Originator would be required to seek recovery of the money from Beneficiary. Subsection (d) prevents this result and puts the risk of loss on Bank A by providing that the early execution does not result in acceptance until the execution date. Since on April 3 Originator's order was not yet accepted, Originator can cancel it under Section 4A-211(b). The result is that Bank A is not entitled to payment from Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by mistake. If Originator's payment order is cancelled, Bank A becomes the originator of an erroneous funds transfer to Beneficiary. Bank A has the burden of recovering payment from Beneficiary on the basis of a payment by mistake. If Beneficiary received the money in good faith in payment of a debt owed to Beneficiary by Originator, the law of mistake and restitution may allow Beneficiary to keep all or part of the money received. If Originator owed money to Beneficiary, Bank A has paid Originator's debt and, under the law of restitution, which applies pursuant to Section 1-103, Bank A is subrogated to Beneficiary's rights against Originator on the debt.

If Bank A is the Beneficiary's bank and Bank A credited Beneficiary's account and released the funds to Beneficiary on April 1, the analysis is similar. If Originator's order is cancelled, Bank A has paid Beneficiary by mistake. The right of Bank A to recover the payment from Beneficiary is similar to Bank A's rights in the preceding paragraph.

§ 25-4A-210. Rejection of payment order.

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is cancelled pursuant to G.S. 25-4A-211(d) or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. With respect to payment orders issued to a receiving bank other than the beneficiary's bank, notice of rejection is not necessary to prevent acceptance of the order. Acceptance can occur only if the receiving bank executes the order. Section 4A-209(a). But notice of rejection will routinely be given by such a bank in cases in which the bank cannot or is not willing to execute the order for some reason. There are many reasons why a bank doesn't execute an order. The payment order may not clearly instruct the receiving bank because of some ambiguity in the order or an internal inconsistency. In some cases, the receiving bank may not be able to carry out the instruction because of equipment failure, credit limitations on the receiving bank, or some other factor which makes proper execution of the order infeasible. In those cases notice of rejection is a means of informing the sender of the facts so that a corrected payment order can be transmitted or the sender can seek alternate means of completing the funds transfer. The other major reason for not executing an order is that the sender's account is insufficient to cover the order and the receiving bank is not willing to give credit to the sender. If the sender's account is sufficient to cover the order and the receiving bank chooses not to execute the order, notice of rejection is necessary to prevent liability to pay interest to the sender if the case falls within Section 4A-210(b) which is discussed in Comment 3.

2. A payment order to the beneficiary's bank can be accepted by inaction of the bank. Section 4A-209(b)(2) and (3). To prevent acceptance under those provisions it is necessary for the receiving bank to send notice of rejection before acceptance occurs. Subsection (a) of Section 4A-210 states the rule that rejection is accomplished by giving notice of rejection. This incorporates the definitions in Section 1-201(26). Rejection is effective when notice is given if it is given by a means that is reasonable in the circumstances. Otherwise it is effective when the notice is received. The question of when rejection is effective is important only in the relatively few cases under subsection (b)(2) and (3) in which a notice of rejection is necessary to prevent acceptance. The question of whether a particular means is reasonable depends on the facts in a particular case. In a very large percentage of cases the sender and the receiving bank will be in direct electronic contact with each other and in those cases a notice of rejection can be transmitted instantaneously. Since time is of the essence in a large proportion of funds transfers, some quick means of transmission would usually be required, but this is not always the case. The parties may specify by agreement the means by which communication between the parties is to be made.

3. Subsection (b) deals with cases in which a sender does not learn until after the execution date that the sender's order has not been executed. It applies only to cases in which the receiving bank was assured of payment because the sender's account was sufficient to cover the order. Normally, the receiving bank will accept the sender's order if it is assured of payment, but there may be some cases in which the bank chooses to reject. Unless the receiving bank had obligated itself by agreement to accept, the failure to accept is not wrongful. There is no duty of the receiving bank to accept the payment order unless it is obliged to accept by express agreement. Section 4A-212. But even if the bank has not acted wrongfully, the receiving bank had the use of the sender's money that the sender could reasonably assume was to be the source of payment of the funds transfer. Until the sender learns that the order was not accepted the sender is denied the use of that money. Subsection (b) obliges the receiving bank to pay interest to the sender as restitution unless the sender receives notice of rejection on the execution date. The time of receipt of notice is determined pursuant to G.S. 1-201(27). The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the execution date, the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

4. Subsection (d) treats acceptance and rejection as mutually exclusive. If a payment order has been accepted, rejection of that order becomes impossible. If a payment order has been rejected it cannot be accepted later by the receiving bank. Once notice of rejection has been given, the sender may have acted on the notice by making the payment through other channels. If the receiving bank wants to act on a payment order that it has rejected it has to obtain the consent of the sender. In that case the consent of the sender would amount to the giving of a second payment order that substitutes for the rejected first order. If the receiving bank suspends payments (Section 4-104(1)(k)), subsection (c) provides that unaccepted payment orders are deemed rejected at the time suspension of payments occurs. This prevents acceptance by passage of time under Section 4A-209(b)(3).

§ 25-4A-211. Cancellation and amendment of payment order.

(a) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to subsection (a), a communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is cancelled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A cancelled payment order cannot be accepted. If an accepted payment order is cancelled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorneys' fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with subsection (c)(2). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section deals with cancellation and amendment of payment orders. It states the conditions under which cancellation or amendment is both effective and rightful. There is no concept of wrongful cancellation or amendment of a payment order. If the conditions stated in this section are not met the attempted cancellation or amendment is not effective. If the stated conditions are met the cancellation or amendment is effective and rightful. The sender of a payment order may want to withdraw or change the order because the sender has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason. One common situation is that of multiple transmission of the same order. The sender that mistakenly transmits the same order twice wants to correct the mistake by cancelling the duplicate order. Or, a sender may have intended to order a payment of $1,000,000 but mistakenly issued an order to pay $10,000,000. In this case the sender might try to correct the mistake by cancelling the order and issuing another order in the proper amount. Or, the mistake could be corrected by amending the order to change it to the proper amount. Whether the error is corrected by amendment or cancellation and reissue the net result is the same. This result is stated in the last sentence of subsection (e).

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank "orally, electronically, or in writing." The quoted phrase is consistent with the language of Section 4A-103(a) applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the communication was or was not effective to cancel or amend a previously verified payment order.

3. If the receiving bank has not yet accepted the order, there is no reason why the sender should not be able to cancel or amend the order unilaterally so long as the requirements of subsections (a) and (b) are met. If the receiving bank has accepted the order, it is possible to cancel or amend but only if the requirements of subsection (c) are met.

First consider the case of a receiving bank other than the beneficiary's bank. If the bank has not yet accepted the order, the sender can unilaterally cancel or amend. The communication amending or cancelling the payment order must be received in time to allow the bank to act on it before the bank issues its payment order in execution of the sender's order. The time that the sender's communication is received is governed by Section 4A-106. If a payment order does not specify a delayed payment date or execution date, the order will normally be executed shortly after receipt. Thus, as a practical matter, the sender will have very little time in which to instruct cancellation or amendment before acceptance. In addition, a receiving bank will normally have cut-off times for receipt of such communications, and the receiving bank is not obliged to act on communications received after the cut-off hour. Cancellation by the sender after execution of the order by the receiving bank requires the agreement of the bank unless a funds transfer rule otherwise provides. Subsection (c). Although execution of the sender's order by the receiving bank does not itself impose liability on the receiving bank (under Section 4A-402 no liability is incurred by the receiving bank to pay its order until it is accepted), it would commonly be the case that acceptance follows shortly after issuance. Thus, as a practical matter, a receiving bank that has executed a payment order will incur a liability to the next bank in the chain before it would be able to act on the cancellation request of its customer. It is unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank.

The statute does not state how or when the agreement of the receiving bank must be obtained for cancellation after execution. The receiving bank's consent could be obtained at the time cancellation occurs or it could be based on a preexisting agreement. Or, a funds transfer system rule could provide that cancellation can be made unilaterally by the sender. By virtue of that rule any receiving bank covered by the rule is bound. Section 4A-501. If the receiving bank has already executed the sender's order, the bank would not consent to cancellation unless the bank to which the receiving bank has issued its payment order consents to cancellation of that order. It makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled. Under subsection (c)(1), if a receiving bank consents to cancellation of the payment order after it is executed, the cancellation is not effective unless the receiving bank also cancels the payment order issued by the bank.

4. With respect to a payment order issued to the beneficiary's bank, acceptance is particularly important because it creates liability to pay the beneficiary, it defines when the originator pays its obligation to the beneficiary, and it defines when any obligation for which the payment is made is discharged. Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree. Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated. The following examples illustrate subsection (c)(2):

Case #1. Originator's Bank executed a payment order issued in the name of its customer as sender. The order was not authorized by the customer and was fraudulently issued. Beneficiary's Bank accepted the payment order issued by Originator's Bank. Under subsection (c)(2) Originator's Bank can cancel the order if Beneficiary's Bank consents. It doesn't make any difference whether the payment order that Originator's Bank accepted was or was not enforceable against the customer under Section 4A-202(b). Verification under that provision is important in determining whether Originator's Bank or the customer has the risk of loss, but it has no relevance under Section 4A-211(c)(2). Whether or not verified, the payment order was not authorized by the customer. Cancellation of the payment order to Beneficiary's Bank causes the acceptance of Beneficiary's Bank to be nullified. Subsection (e). Beneficiary's Bank is entitled to recover payment from the beneficiary to the extent allowed by the law of mistake and restitution. In this kind of case the beneficiary is usually a party to the fraud who has no right to receive or retain payment of the order.

Case #2. Originator owed Beneficiary $1,000,000 and ordered Bank A to pay that amount to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B, but by mistake issued a duplicate order as well. Bank B accepted both orders. Under subsection (c)(2)(i) cancellation of the duplicate order could be made by Bank A with the consent of Bank B. Beneficiary has no right to receive or retain payment of the duplicate payment order if only $1,000,000 was owed by Originator to Beneficiary. If Originator owed $2,000,000 to Beneficiary, the law of restitution might allow Beneficiary to retain the $1,000,000 paid by Bank B on the duplicate order. In that case Bank B is entitled to reimbursement from Bank A under subsection (f).

Case #3. Originator owed $1,000,000 to X. Intending to pay X, Originator ordered Bank A to pay $1,000,000 to Y's account in Bank B. Bank A issued a complying payment order to Bank B which Bank B accepted by releasing the $1,000,000 to Y. Under subsection (c)(2)(ii) Bank A can cancel its payment order to Bank B with the consent of Bank B if Y was not entitled to receive payment from Originator. Originator can also cancel its order to Bank A with Bank A's consent. Subsection (c)(1). Bank B may recover the $1,000,000 from Y unless the law of mistake and restitution allows Y to retain some or all of the amount paid. If no debt was owed to Y, Bank B should have a right of recovery.

Case #4. Originator owed Beneficiary $10,000. By mistake Originator ordered Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B which accepted by notifying Beneficiary of its right to withdraw $1,000,000. Cancellation is permitted in this case under subsection (c)(2)(iii). If Bank B paid Beneficiary it is entitled to recover the payment except to the extent the law of mistake and restitution allows Beneficiary to retain payment. In this case Beneficiary might be entitled to retain $10,000, the amount of the debt owed to Beneficiary. If Beneficiary may retain $10,000, Bank B would be entitled to $10,000 from Bank A pursuant to subsection (f). In this case Originator also cancelled its order. Thus Bank A would be entitled to $10,000 from Originator pursuant to subsection (f).

5. Unless constrained by a funds transfer system rule, a receiving bank may agree to cancellation or amendment of the payment order under subsection (c) but is not required to do so regardless of the circumstances. If the receiving bank has incurred liability as a result of its acceptance of the sender's order, there are substantial risks in agreeing to cancellation or amendment. This is particularly true for a beneficiary's bank. Cancellation or amendment after acceptance by the beneficiary's bank can be made only in the four cases stated and the beneficiary's bank may not have any way of knowing whether the requirements of subsection (c) have been met or whether it will be able to recover payment from the beneficiary that received payment. Even with indemnity the beneficiary's bank may be reluctant to alienate its customer, the beneficiary, by denying the customer the funds. Subsection (c) leaves the decision to the beneficiary's bank unless the

consent of the beneficiary's bank is not required under a funds transfer system rule or other interbank agreement. If a receiving bank agrees to cancellation or amendment under subsection (c)(1) or (2), it is automatically entitled to indemnification from the sender under subsection (f). The indemnification provision recognizes that a sender has no right to cancel a payment order after it is accepted by the receiving bank. If the receiving bank agrees to cancellation, it is doing so as an accommodation to the sender and it should not incur a risk of loss in doing so.

6. Acceptance by the receiving bank of a payment order issued by the sender is comparable to acceptance of an offer under the law of contracts. Under that law the death or legal incapacity of an offeror terminates the offer even though the offeree has no notice of the death or incapacity. Restatement Second, Contracts G.S. 48. Comment a. to that section states that the "rule seems to be a relic of the obsolete view that a contract requires a 'meeting of minds,' and it is out of harmony with the modern doctrine that a manifestation of assent is effective without regard to actual mental assent." Subsection (g), which reverses the Restatement rule in the case of a payment order, is similar to Section 4-405(1) which applies to checks. Subsection (g) does not address the effect of the bankruptcy of the sender of a payment order before the order is accepted, but the principle of subsection (g) has been recognized in Bank of Marin v. England, 385 U.S. 99 (1966). Although Bankruptcy Code Section 542(c) may not have been drafted with wire transfers in mind, its language can be read to allow the receiving bank to charge the sender's account for the amount of the payment order if the receiving bank executed it in ignorance of the bankruptcy.

7. Subsection (d) deals with stale payment orders. Payment orders normally are executed on the execution date or the day after. An order issued to the beneficiary's bank is normally accepted on the payment date or the day after. If a payment order is not accepted on its execution or payment date or shortly thereafter, it is probable that there was some problem with the terms of the order or the sender did not have sufficient funds or credit to cover the amount of the order. Delayed acceptance of such an order is normally not contemplated, but the order may not have been cancelled by the sender. Subsection (d) provides for cancellation by operation of law to prevent an unexpected delayed acceptance.

8. A funds transfer system rule can govern rights and obligations between banks that are parties to payment orders transmitted over the system even if the rule conflicts with Article 4A. In some cases, however, a rule governing a transaction between two banks can affect a third party in an unacceptable way. Subsection (h) deals with such a case. A funds transfer system rule cannot allow cancellation of a payment order accepted by the beneficiary's bank if the rule conflicts with subsection (c)(2). Because rights of the beneficiary and the originator are directly affected by acceptance, subsection (c)(2) severely limits cancellation. These limitations cannot be altered by funds transfer system rule.

§ 25-4A-212. Liability and duty of receiving bank regarding unaccepted payment order.

If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this Article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in G.S. 25-4A-209, and liability is limited to that provided in this Article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this Article or by express agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

With limited exceptions stated in this Article, the duties and obligations of receiving banks that carry out a funds transfer arise only as a result of acceptance of payment orders or of agreements made by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and Section 4A-210(b). A receiving bank is not like a collecting bank under Article 4. No receiving bank, whether it be an originator's bank, an intermediary bank or a beneficiary's bank, is an agent for any other party in the funds transfer.

PART 3.

EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK.

§ 25-4A-301. Execution and execution date.

(a) A payment order is "executed" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) "Execution date" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. The terms "executed," "execution" and "execution date" are used only with respect to a payment order to a receiving bank other than the beneficiary's bank. The beneficiary's bank can accept the payment order that it receives, but it does not execute the order. Execution refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. A receiving bank has executed an order even if the order issued by the bank does not carry out the order received by the bank. For example, the bank may have erroneously issued an order to the wrong beneficiary, or in the wrong amount or to the wrong beneficiary's bank. In each of these cases execution has occurred but the execution is erroneous. Erroneous execution is covered in Section 4A-303.

2. "Execution date" refers to the time a payment order should be executed rather than the day it is actually executed. Normally the sender will not specify an execution date, but most payment orders are meant to be executed immediately. Thus, the execution date is normally the day the order is received by the receiving bank. It is common for the sender to specify a "payment date" which is defined in Section 4A-401 as "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank." Except for automated clearing house transfers, if a funds transfer is entirely within the United States and the payment is to be carried out electronically, the execution date is the payment date unless the order is received after the payment date. If the payment is to be carried out through an automated clearing house, execution may occur before the payment date. In an ACH transfer the beneficiary is usually paid one or two days after issue of the originator's payment order. The execution date is determined by the stated payment date and is a date before the payment date on which execution is reasonably necessary to allow payment on the payment date. A funds transfer system rule could also determine the execution date of orders received by the receiving bank if both the sender and the receiving bank are participants in the funds transfer system. The execution date can be determined by the payment order itself or by separate instructions of the sender or an agreement of the sender and the receiving bank. The second sentence of subsection (b) must be read in the light of Section 4A-106 which states that if a payment order is received after the cut-off time of the receiving bank it may be treated by the bank as received at the opening of the next funds transfer business day.

3. Execution on the execution date is timely, but the order can be executed before or after the execution date. Section 4A-209(d) and Section 4A-402(c) state the consequences of early execution and Section 4A-305(a) states the consequences of late execution.

§ 25-4A-302. Obligations of receiving bank in execution of payment order.

(a) Except as provided in subsections (b) through (d), if the receiving bank accepts a payment order pursuant to G.S. 25-4A-209 (a), the bank has the following obligations in executing the order:

(1) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(2) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless subsection (a)(2) applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. In the absence of agreement, the receiving bank is not obliged to execute an order of the sender. Section 4A-212. Section 4A-302 states the manner in which the receiving bank may execute the sender's order if execution occurs. Subsection (a)(1) states the residual rule. The payment order issued by the receiving bank must comply with the sender's order and, unless some other rule is stated in the section, the receiving bank is obliged to follow any instruc-

tion of the sender concerning which funds transfer system is to be used, which intermediary banks are to be used, and what means of transmission is to be used. The instruction of the sender may be incorporated in the payment order itself or may be given separately. For example, there may be a master agreement between the sender and receiving bank containing instructions governing payment orders to be issued from time to time by the sender to the receiving bank. In most funds transfers, speed is a paramount consideration. A sender that wants assurance that the funds transfer will be expeditiously completed can specify the means to be used. The receiving bank can follow the instructions literally or it can use an equivalent means. For example, if the sender instructs the receiving bank to transmit by telex, the receiving bank could use telephone instead. Subsection (c). In most cases the sender will not specify a particular means but will use a general term such as "by wire" or "wire transfer" or "as soon as possible." These words signify that the sender wants a same-day transfer. In these cases the receiving bank is required to use a telephonic or electronic communication to transmit its order and is also required to instruct any intermediary bank to which it issues its order to transmit by similar means. Subsection (a)(2). In other cases, such as an automated clearing house transfer, a same-day transfer is not contemplated. Normally the sender's instruction or the context in which the payment order is received makes clear the type of funds transfer that is appropriate. If the sender states a payment date with respect to the payment order, the receiving bank is obliged to execute the order at a time and in a manner to meet the payment date if that is feasible. Subsection (a)(2). This provision would apply to many ACH transfers made to pay recurring debts of the sender. In other cases, involving relatively small amounts, time may not be an important factor and cost may be a more important element. Fast means, such as telephone or electronic transmission, are more expensive than slow means such as mailing. Subsection (c) states that in the absence of instructions the receiving bank is given discretion to decide. It may issue its payment order by first class mail or by any means reasonable in the circumstances. Section 4A-305 states the liability of a receiving bank for breach of the obligations stated in Section 4A-302.

2. Subsection (b) concerns the choice of intermediary banks to be used in completing the funds transfer, and the funds transfer system to be used. If the receiving bank is not instructed about the matter, it can issue an order directly to the beneficiary's bank or can issue an order to an intermediary bank. The receiving bank also has discretion concerning use of a funds transfer system. In some cases it may be reasonable to use either an automated clearing house system or a wire transfer system such as Fedwire or CHIPS. Normally, the receiving bank will follow the instruction of the sender in these matters, but in some cases it may be prudent for the bank not to follow instructions. The sender may have designated a funds transfer system to be used in carrying out the funds transfer, but it may not be feasible to use the designated system because of some impediment such as a computer breakdown which prevents prompt execution of the order. The receiving bank is permitted to use an alternate means of transmittal in a good faith effort to execute the order expeditiously. The same leeway is not given to the receiving bank if the sender designates an intermediary bank through which the funds transfer is to be routed. The sender's designation of that intermediary bank may mean that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized. The receiving bank could choose to route the transfer to another intermediary bank and then to the designated intermediary bank if there was some reason such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but the designated intermediary bank cannot be circumvented. To do so violates the sender's instructions.

3. The normal rule, under subsection (a)(1), is that the receiving bank, in executing a payment order, is required to issue a payment order that complies as to amount with that of the sender's order. In most cases the receiving bank issues an order equal to the amount of the sender's order and makes a separate charge for services and expenses in executing the sender's order. In some cases, particularly if it is an intermediary bank that is executing an order, charges are collected by deducting them from the amount of the payment order issued by the executing bank. If that is done, the amount of the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's payment order. For example, Originator, in order to pay an obligation of $1,000,000 owed to Beneficiary, issues a payment order to Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank. Originator's Bank issues a payment order to Intermediary Bank for $1,000,000 and debits Originator's account for $1,000,010. The extra $10 is the fee of Originator's Bank. Intermediary Bank executes the payment order of Originator's Bank by issuing a payment order to Beneficiary's Bank for $999,990, but under § 4A-402(c) is entitled to receive $1,000,000 from Originator's bank. The $10 difference is the fee of Intermediary Bank.

Beneficiary's Bank credits Beneficiary's account for $999,990. When Beneficiary's Bank accepts the payment order of Intermediary Bank the result is a payment of $999,990 from Originator to Beneficiary. Section 4A-406(a). If that payment discharges the $1,000,000 debt, the effect is that Beneficiary has paid the charges of Intermediary Bank and Originator has paid charges of Originator's Bank. Subsection (d) of Section 4A-302 allows Intermediary Bank to collect its charges by deducting them from the amount of the payment order, but only if instructed to do so by Originator's Bank. Originator's Bank is not authorized to give that instruction to Intermediary Bank unless Originator authorized the instruction. Thus, Originator can control how the charges of Originator's Bank and Intermediary Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's Bank to Beneficiary.

In the case discussed in the preceding paragraph the $10 charge is trivial in relation to the amount of the payment and it may not be important to Beneficiary how the charge is paid. But it may be very important if the $1,000,000 obligation represented the price of exercising a right such as an option favorable to Originator and unfavorable to Beneficiary. Beneficiary might well argue that it was entitled to receive $1,000,000. If the option was exercised shortly before its expiration date, the result could be loss of the option benefit because the required payment of $1,000,000 was not made before the option expired. Section 4A-406(c) allows Originator to preserve the option benefit. The amount received by Beneficiary is deemed to be $1,000,000 unless Beneficiary demands the $10 and Originator does not pay it.

§ 25-4A-303. Erroneous execution of payment order.

(a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under G.S. 25-4A-402(c) if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under G.S. 25-4A-402(c) if (i) that subsection is otherwise satisfied and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Section 4A-303 states the effect of erroneous execution of a payment order by the receiving bank. Under Section 4A-402(c) the sender of a payment order is obliged to pay the amount of the order to the receiving bank if the bank executes the order, but the obligation to pay is excused if the beneficiary's bank does not accept a payment order instructing payment to the beneficiary of the sender's order. If erroneous execution of the sender's order causes the

wrong beneficiary to be paid, the sender is not required to pay. If erroneous execution causes the wrong amount to be paid the sender is not obliged to pay the receiving bank an amount in excess of the amount of the sender's order. Section 4A-303 takes precedence over Section 4A-402(c) and states the liability of the sender and the rights of the receiving bank in various cases of erroneous execution.

2. Subsections (a) and (b) deal with cases in which the receiving bank executes by issuing a payment order in the wrong amount. If Originator ordered Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank, but Originator's Bank erroneously instructed Beneficiary's Bank to pay $2,000,000 to Beneficiary's account, subsection (a) applies. If Beneficiary's Bank accepts the order of Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank, but Originator's Bank is entitled to receive only $1,000,000 from Originator. Originator's Bank is entitled to recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution. Originator's Bank would normally have a right to recover the overpayment from Beneficiary, but in unusual cases the law of restitution might allow Beneficiary to keep all or part of the overpayment. For example, if Originator owed $2,000,000 to Beneficiary and Beneficiary received the extra $1,000,000 in good faith in discharge of the debt, Beneficiary may be allowed to keep it. In this case Originator's Bank has paid an obligation of Originator and under the law of restitution, which applies through Section 1-103, Originator's Bank would be subrogated to Beneficiary's rights against Originator on the obligation paid by Originator's Bank.

If Originator's Bank erroneously executed Originator's order by instructing Beneficiary's Bank to pay less than $1,000,000, subsection (b) applies. If Originator's Bank corrects its error by issuing another payment order to Beneficiary's Bank that results in payment of $1,000,000 to Beneficiary, Originator's Bank is entitled to payment of $1,000,000 from Originator. If the mistake is not corrected, Originator's Bank is entitled to payment from Originator only in the amount of the order issued by Originator's Bank.

3. Subsection (a) also applies to duplicate payment orders. Assume Originator's Bank properly executes Originator's $1,000,000 payment order and then by mistake issues a second $1,000,000 payment order in execution of Originator's order. If Beneficiary's Bank accepts both orders issued by Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank but Originator's Bank is entitled to receive only $1,000,000 from Originator. The remedy of Originator's Bank is the same as that of a receiving bank that executes by issuing an order in an amount greater than the sender's order. It may recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution and in a proper case as stated in Comment 2 may have subrogation rights if it is not entitled to recover from Beneficiary.

4. Suppose Originator instructs Originator's Bank to pay $1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank erroneously instructs Beneficiary's Bank to pay $1,000,000 to Account #12346 and Beneficiary's Bank accepted. Subsection (c) covers this case. Originator is not obliged to pay its payment order, but Originator's Bank is required to pay $1,000,000 to Beneficiary's Bank. The remedy of Originator's Bank is to recover $1,000,000 from the holder of Account #12346 that received payment by mistake. Recovery based on the law of mistake and restitution is described in Comment 2.

§ 25-4A-304. Duty of sender to report erroneously executed payment order.

If the sender of a payment order that is erroneously executed as stated in G.S. 25-4A-303 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under G.S. 25-4A-402(d) for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is identical in effect to Section 4A-204 which applies to unauthorized orders issued in the name of a customer of the receiving bank. The rationale is stated in Comment 2 to Section 4A-204.

§ 25-4A-305. Liability for late or improper execution or failure to execute payment order.

(a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of G.S. 25-4A-302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of G.S. 25-4A-302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a), resulting from the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorneys' fees are recoverable if demand for compensation under subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) and the agreement does not provide for damages, reasonable attorneys' fees are recoverable if demand for compensation under subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a). The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary

Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the breach, the expenses of the sender in the funds transfer and attorney's fees. This subsection reflects the judgement that imposition of consequential damages on a bank for commission of an error is not justified.

The leading common law case on the subject of consequential damages is Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), in which Swiss Bank, an intermediary bank, failed to execute a payment order. Because the beneficiary did not receive timely payment the originator lost a valuable ship charter. The lower court awarded the originator $2.1 million for lost profits even though the amount of the payment order was only $27,000. The Seventh Circuit reversed, in part on the basis of the common law rule of Hadley v. Baxendale that consequential damages may not be awarded unless the defendant is put on notice of the special circumstances giving rise to them. Swiss Bank may have known that the originator was paying the shipowner for the hire of a vessel but did not know that a favorable charter would be lost if the payment was delayed. "Electronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry. Swiss Bank did not have enough information to infer that if it lost a $27,000 payment order it would face liability in excess of $2 million." 673 F.2d at 956.

If Evra means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages. In the typical case transmission of the payment order is made electronically. Personnel of the receiving bank that process payment orders are not the appropriate people to evaluate the risk of liability for consequential damages in relation to the price charged for the wire transfer service. Even if notice is received by higher level management personnel who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of payment orders on an individual basis. This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers. Moreover, in Evra the culpable bank was an intermediary bank with which the originator did not deal. Notice to the originator's bank would not bind the intermediary bank, and it seems impractical for the originator's bank to convey notice of this kind to intermediary banks in the funds transfer. The success of the wholesale wire transfer industry has largely been based on its ability to effect payment at low cost and great speed. Both of these essential aspects of the modern wire transfer system would be adversely affected by a rule that imposed on banks liability for consequential damages. A banking industry amicus brief in Evra stated: "Whether banks can continue to make EFT services available on a widespread basis, by charging reasonable rates, depends on whether they can do so without incurring unlimited consequential risks. Certainly, no bank would handle for $3.25 a transaction entailing potential liability in the millions of dollars."

As the court in Evra also noted, the originator of the funds transfer is in the best position to evaluate the risk that a funds transfer will not be made on time and to manage that risk by issuing a payment order in time to allow monitoring of the transaction. The originator, by asking the beneficiary, can quickly determine if the funds transfer has been completed. If the originator has sent the payment order at a time that allows a reasonable margin for correcting error, no loss is likely to result if the transaction is monitored. The other published cases on this issue reach the Evra result. Central Coordinates, Inc. v. Morgan Guaranty Trust Co., 40 U.C.C. Rep. Serv. 1340 (N.Y.Sup.Ct.1985), and Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep.Serv.2d 171 (D.Md.1986).

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express written agreement of the receiving bank. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212. The measure of damages for breach of an agreement to accept a payment order is the same as that stated in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express written agreement of the receiving bank.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsection (a), (b) and (d). If additional damages are recoverable because provided for by an express written agreement, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of

damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305.

PART 4.

PAYMENT.

§ 25-4A-401. Payment date.

"Payment date" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

"Payment date" refers to the day the beneficiary's bank is to pay the beneficiary. The payment date may be expressed in various ways so long as it indicates the day the beneficiary is to receive payment. For example, in ACH transfers the payment date is the equivalent of "settlement date" or "effective date." Payment date applies to the payment order issued to the beneficiary's bank, but a payment order issued to a receiving bank other than the beneficiary's bank may also state a date for payment to the beneficiary. In the latter case, the statement of a payment date is to instruct the receiving bank concerning time of execution of the sender's order. Section 4A-301(b).

§ 25-4A-402. Obligation of sender to pay receiving bank.

(a) This section is subject to G.S. 25-4A-205 and G.S. 25-4A-207.

(b) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection is subject to subsection (e) and to G.S. 25-4A-303. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in G.S. 25-4A-204 and G.S. 25-4A-304, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in subsection (c) and an intermediary bank is obliged to refund payment as stated in subsection (d) but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in G.S. 25-4A-302(a)(1), to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in subsection (d).

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (c) or to receive refund under subsection (d) may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (b) states that the sender of a payment order to the beneficiary's bank must pay the order when the beneficiary's bank accepts the order. At that point the beneficiary's bank is obliged to pay the beneficiary. Section 4A-404(a). The last clause of subsection (b) covers a case of premature acceptance by the beneficiary's bank. In some funds transfers, notably automated clearing house transfers, a beneficiary's bank may receive a payment order with a payment date after the day the order is received. The beneficiary's bank might accept the order before the payment date by notifying the beneficiary of receipt of the order. Although the acceptance obliges the beneficiary's bank to pay the beneficiary, payment is not due until the payment date. The last clause of subsection (b) is consistent with that result. The beneficiary's bank is also not entitled to payment from the sender until the payment date.

2. Assume that Originator instructs Bank A to order immediate payment to the account of Beneficiary in Bank B. Execution of Originator's payment order by Bank A is acceptance under Section 4A-209(a). Under the second sentence of Section 4A-402(c) the acceptance creates an obligation of Originator to pay Bank A the amount of the order. The last clause of that sentence deals with attempted funds transfers that are not completed. In that event the obligation of the sender to pay its payment order is excused. Originator makes payment to Beneficiary when Bank B, the beneficiary's bank, accepts a payment order for the benefit of Beneficiary. Section 4A-406(a). If that acceptance by Bank B does not occur, the funds transfer has miscarried because Originator has not paid Beneficiary. Originator doesn't have to pay its payment order, and if it has already paid it is entitled to refund of the payment with interest. The rate of interest is stated in Section 4A-506. This "money-back guarantee" is an important protection of Originator. Originator is assured that it will not lose its money if something goes wrong in the transfer. For example, risk of loss resulting from payment to the wrong beneficiary is borne by some bank, not by Originator. The most likely reason for noncompletion is a failure to execute or an erroneous execution of a payment order by Bank A or an intermediary bank. Bank A may have issued its payment order to the wrong bank or it may have identified the wrong beneficiary in its order. The money-back guarantee is particularly important to Originator if noncompletion of the funds transfer is due to the fault of an intermediary bank rather than Bank A. In that case Bank A must refund payment to Originator, and Bank A has the burden of obtaining refund from the intermediary bank that it paid.

Subsection (c) can result in loss if an intermediary bank suspends payments. Suppose Originator instructs Bank A to pay to Beneficiary's account in Bank B and to use Bank C as an intermediary bank. Bank A executes Originator's order by issuing a payment order to Bank C. Bank A pays Bank C. Bank C fails to execute the order of Bank A and suspends payments. Under subsections (c) and (d), Originator is not obliged to pay Bank A and is entitled to refund from Bank A of any payment that it may have made. Bank A is entitled to a refund from Bank C, but Bank C is insolvent. Subsection (e) deals with this case. Bank A was required to issue its payment order to Bank C because Bank C was designated as an intermediary bank by Originator. Section 4A-302(a)(1). In this case Originator takes the risk of insolvency of Bank C. Under subsection (e), Bank A is entitled to payment from Originator and Originator is subrogated to the right of Bank A under subsection (d) to refund of payment from Bank C.

3. A payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order.

§ 25-4A-403. Payment by sender to receiving bank.

(a) Payment of the sender's obligation under G.S. 25-4A-402 to pay the receiving bank occurs as follows:

(1) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a Federal Reserve Bank or through a funds-transfer system.

(2) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(3) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under G.S. 25-4A-402 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by subsection (a), the time when payment of the sender's obligation under G.S. 25-4A-402(b) or G.S. 25-4A-402(c) occurs is governed by applicable principles of law that determine when an obligation is satisfied. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section defines when a sender pays the obligation stated in Section 4A-402. If a group of two or more banks engage in funds transfers with each other, the participating banks will sometimes be senders and sometimes receiving banks. With respect to payment orders other than Fedwires, the amounts of the various payment orders may be credited and debited to accounts of one bank with another or to a clearing house account of each bank and amounts owed and amounts due are netted. Settlement is made through a Federal Reserve Bank by charges to the Federal Reserve accounts of the net debtor banks and credits to the Federal Reserve accounts of the net creditor banks. In the case of Fedwires the sender's obligation is settled by a debit to the Federal Reserve account of the sender and a credit to the Federal Reserve account of the receiving bank at the time the receiving bank receives the payment order. Both of these cases are covered by subsection (a)(1). When the Federal Reserve settlement becomes final the obligation of the sender under Section 4A-402 is paid.

2. In some cases a bank does not settle an obligation owed to another bank through a Federal Reserve Bank. This is the case if one of the banks is a foreign bank without access to the Federal Reserve payment system. In this kind of case, payment is usually made by credits or debits to accounts of the two banks with each other or to accounts of the two banks in a third bank. Suppose Bank B has an account in Bank A. Bank A advises Bank B that its account in Bank A has been credited $1,000,000 and that the credit is immediately withdraw-

able. Bank A also instructs Bank B to pay $1,000,000 to the account of Beneficiary in Bank B. This case is covered by subsection (a)(2). Bank B may want to immediately withdraw this credit. For example, it might do so by instructing Bank A to debit the account and pay some third party. Payment by Bank A to Bank B of Bank A's payment order occurs when the withdrawal is made. Suppose Bank B does not withdraw the credit. Since Bank B is the beneficiary's bank, one of the effects of receipt of payment by Bank B is that acceptance of Bank A's payment order automatically occurs at the time of payment. Section 4A-209(b)(2). Acceptance means that Bank B is obliged to pay $1,000,000 to Beneficiary. Section 4A-404(a). Subsection (a)(2) of Section 4A-403 states that payment does not occur until midnight if the credit is not withdrawn. This allows Bank B an opportunity to reject the order if it does not have time to withdraw the credit to its account and it is not willing to incur the liability to Beneficiary before it has use of the funds represented by the credit.

3. Subsection (a)(3) applies to a case in which the sender (bank or nonbank) has a funded account in the receiving bank. If Sender has an account in Bank and issues a payment order to Bank, Bank can obtain payment from Sender by debiting the account of Sender, which pays its Section 4A-402 obligation to Bank when the debit is made.

4. Subsection (b) deals with multilateral settlements made through a funds transfer system and is based on the CHIPS settlement system. In a funds transfer system such as CHIPS, which allows the various banks that transmit payment orders over the system to settle obligations at the end of each day, settlement is not based on individual payment orders. Each bank using the system engages in funds transfers with many other banks using the system. Settlement for any participant is based on the net credit or debit position of that participant with all other banks using the system. Subsection (b) is designed to make clear that the obligations of any sender are paid when the net position of that sender is settled in accordance with the rules of the funds transfer system. This provision is intended to invalidate any argument, based on common-law principles, that multilateral netting is not valid because mutuality of obligation is not present. Subsection (b) dispenses with any mutuality of obligation requirements. Subsection (c) applies to cases in which two banks send payment orders to each other during the day and settle with each other at the end of the day or at the end of some other period. It is similar to subsection (b) in that it recognizes that a sender's obligation to pay a payment order is satisfied by a setoff. The obligations of each bank as sender to the other as receiving bank are obligations of the bank itself and not as representative of customers. These two sections are important in the case of insolvency of a bank. They make clear that liability under Section 4A-402 is based on the net position of the insolvent bank after setoff.

5. Subsection (d) relates to the uncommon case in which the sender doesn't have an account relationship with the receiving bank and doesn't settle through a Federal Reserve Bank. An example would be a customer that pays over the counter for a payment order that the customer issues to the receiving bank. Payment would normally be by cash, check or bank obligation. When payment occurs is determined by law outside Article 4A.

§ 25-4A-404. Obligation of beneficiary's bank to pay and give notice to beneficiary.

(a) Subject to G.S. 25-4A-211(e), 25-4A-405(d), and 25-4A-405(e), if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first-class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorneys' fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in subsection (a) may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (b) may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. The first sentence of subsection (a) states the time when the obligation of the beneficiary's bank arises. The second and third sentences state when the beneficiary's bank must make funds available to the beneficiary. They also state the measure of damages for failure, after demand, to comply. Since the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., also governs funds availability in a funds transfer, the second and third sentences of subsection (a) may be subject to preemption by that Act.

2. Subsection (a) provides that the beneficiary of an accepted payment order may recover consequential damages if the beneficiary's bank refuses to pay the order after demand by the beneficiary if the bank at that time had notice of the particular circumstances giving rise to the damages. Such damages are recoverable only to the extent the bank had "notice of the damages." The quoted phrase requires that the bank have notice of the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude. There is no requirement that the bank have notice of the exact or even the approximate amount of the damages, but if the amount of damages is extraordinary the bank is entitled to notice of that fact. For example, in Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), failure to complete a funds transfer of only $27,000 required to retain rights to a very favorable ship charter resulted in a claim for more than $2,000,000 of consequential damages. Since it is not reasonably foreseeable that a failure to make a relatively small payment will result in damages of this magnitude, notice is not sufficient if the beneficiary's bank has notice only that the $27,000 is necessary to retain rights on a ship charter. The bank is entitled to notice that an exceptional amount of damages will result as well. For example, there would be adequate notice if the bank had been made aware that damages of $1,000,000 or more might result.

3. Under the last clause of subsection (a) the beneficiary's bank is not liable for damages if its refusal to pay was "because of a reasonable doubt concerning the right of the beneficiary to payment." Normally there will not be any question about the right of the beneficiary to receive payment. Normally, the bank should be able to determine whether it has accepted the payment order and, if it has been accepted, the first sentence of subsection (a) states that the bank is obliged to pay. There may be uncommon cases, however, in which there is doubt whether acceptance occurred. For example, if acceptance is based on receipt of payment by the beneficiary's bank under Section 4A-403 (a)(1) or (2), there may be cases in which the bank is not certain that payment has been received. There may also be cases in which there is doubt about whether the person demanding payment is the person identified in the payment order as beneficiary of the order.

The last clause of subsection (a) does not apply to cases in which a funds transfer is being used to pay an obligation and a dispute arises between the originator and the beneficiary concerning whether the obligation is in fact owed. For example, the originator may try to prevent payment to the beneficiary by the beneficiary's bank by alleging that the beneficiary is not entitled to payment because of fraud against the originator or a breach of contract relating to the obligation. The fraud or breach of contract claim of the originator may be grounds for recovery by the originator from the beneficiary after the beneficiary is paid, but it does not affect the obligation of the beneficiary's bank to pay the beneficiary. Unless the payment order has been cancelled pursuant to Section 4A-211(c), there is no excuse for refusing to pay the beneficiary and, in a proper case, the refusal may result in consequential damages. Except in the case of a book transfer, in which the beneficiary's bank is also the originator's bank, the originator of a funds transfer cannot cancel a payment order to the beneficiary's bank, with or without the consent of that bank, because the originator is not the sender of that order. Thus, the beneficiary's bank may safely ignore any instruction by the originator to withhold payment to the beneficiary.

4. Subsection (b) states the duty of the beneficiary's bank to notify the beneficiary of receipt of the order. If acceptance occurs under Section 4A-209(b)(1) the beneficiary is normally notified. Thus, subsection (b) applies primarily to cases in which acceptance occurs under Section 4A-209(b)(2) or (3). Notice under subsection (b) is not required if the person entitled to the notice agrees or a funds transfer system rule provides that notice is not required and the beneficiary is given notice of the rule. In ACH transactions the normal practice is not to give notice to the beneficiary unless notice is requested by the beneficiary. This practice can be continued by adoption of a funds transfer system rule. Subsection (a) is not subject to variation by agreement or by a funds transfer system rule.

§ 25-4A-405. Payment by beneficiary's bank to beneficiary.

(a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under G.S. 25-4A-404(a) occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under G.S. 25-4A-404(a) occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in subsections (d) and (e), if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank, and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under G.S. 25-4A-406.

(e) This subsection applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under G.S. 25-4A-406, and (iv) subject to G.S. 25-4A-402(e), each sender in the funds transfer is excused from its obligation to pay its payment order under G.S. 25-4A-402(c) because the funds transfer has not been completed. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under Section 4A-404 to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a)(i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a)(ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502.

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209, the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a), the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209), or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers are made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depositary bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes. Section 4A-405(d) allows the funds transfer system to adopt a rule making payments to beneficiaries provisional. If such a rule is adopted, a beneficiary's bank that releases funds to the beneficiary will be able to recover the payment if it doesn't receive payment of the payment order that it accepted. There are two requirements with respect to the funds transfer system rule. The beneficiary, the beneficiary's bank and the originator's bank must all agree to be bound by the rule and the rule must require that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated. There is no requirement that the notice be given with respect to a particular funds transfer. Once notice of the provisional nature of the payment has been given, the notice is effective for all subsequent payment to or from the person to whom the notice was given. Subsection (d) provides only that the funds transfer system rule must require notice to the beneficiary and the originator. The beneficiary's bank will know what the rule requires, but it has no way of knowing whether the originator's bank complied with the rule. Subsection (d) does not require proof that the originator received notice. If the originator's bank failed to give the required notice and the originator suffered as a result, the appropriate remedy is an action by the originator against the originator's bank based on that failure. But the beneficiary's bank will not be able to get the benefit of subsection (d) unless the beneficiary had notice of the provisional nature of the payment because subsection (d) requires an agreement by the beneficiary to be bound by the rule. Implicit in an agreement to be bound by a rule that makes a payment provisional is a requirement that notice be given of what the rule provides. The notice can be part of the agreement or separately given. For example, notice can be given by providing a copy of the system's operating rules.

With respect to ACH transfers made through a Federal Reserve Bank acting as an intermediary bank, the Federal Reserve Bank is obliged under Section 4A-402(b) to pay a beneficiary's bank that accepts the payment order. Unlike Fedwire transfers, under current ACH practice a Federal Reserve Bank that processes a payment order does not obligate itself to pay if the originator's bank fails to pay the Federal Reserve Bank. It is assumed that the Federal Reserve will use its right of preemption which is recognized in Section 4A-107 to disclaim the Section 4A-402(b) obligation in ACH transactions if it decides to retain the provisional payment rule.

4. Subsection (e) is another exception to subsection (c). It refers to funds transfer systems having loss-sharing rules described in the subsection. CHIPS has proposed a rule that fits the description. Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to contribute funds to allow the system to settle for payment orders sent over the system during the day in the event that one or more banks are unable to meet their settlement obligations. Subsection (e) applies only if CHIPS fails to settle despite the loss-sharing rule. Since funds under the loss-sharing rule will be instantly available to CHIPS and will be in an amount sufficient to cover any failure that can be reasonably anticipated, it is extremely unlikely that CHIPS would ever fail to settle. Thus, subsection (e) addresses an event that should never occur. If that event were to occur, all payment orders made over the system would be cancelled under the CHIPS rule. Thus, no bank would receive settlement, whether or not a failed bank was involved in a particular funds transfer. Subsection (e) provides that each funds transfer in which there is a payment order with respect to which there is a settlement failure is unwound. Acceptance by the beneficiary's bank in each funds transfer is nullified. The consequences of nullification are that the beneficiary has no right to receive or retain payment by the beneficiary's bank, no payment is made by the originator to the beneficiary and each sender in the funds transfer is, subject to Section 4A-402(e), not obliged to pay its payment order and is entitled to refund under Section 4A-402(d) if it has already paid.

§ 25-4A-406. Payment by originator to beneficiary; discharge of underlying obligation.

(a) Subject to G.S. 25-4A-211(e), 25-4A-405(d), and 25-4A-405(e), the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under subsection (a) is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under subsection (a) was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract. If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under G.S. 25-4A-404(a).

(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states the fundamental rule of Article 4A that payment by the originator to the beneficiary is accomplished by providing to the beneficiary the obligation of the beneficiary's bank to pay. Since this obligation arises when the beneficiary's bank accepts a payment order, the originator pays the beneficiary at the time of acceptance and in the amount of the payment order accepted.

2. In a large percentage of funds transfers, the transfer is made to pay an obligation of the originator. Subsection (a) states that the beneficiary is paid by the originator when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. When that happens the effect under subsection (b) is to substitute the obligation of the beneficiary's bank for the obligation of the originator. The effect is similar to that under Article 3 if a cashier's check payable to the beneficiary had been taken by the beneficiary. Normally, payment by funds transfer is sought by the beneficiary because it puts money into the hands of the beneficiary more quickly. As a practical matter the beneficiary and the originator will nearly always agree to the funds transfer in advance. Under subsection (b) acceptance by the beneficiary's bank will result in discharge of the obligation for which payment was made unless the beneficiary had made a contract with respect to the obligation which did not permit payment by the means used. Thus, if there is no contract of the beneficiary with respect to the means of payment of the obligation, acceptance by the beneficiary's bank of a payment order to the account of the beneficiary can result in discharge.

3. Suppose Beneficiary's contract stated that payment of an obligation owed by Originator was to be made by a cashier's check of Bank A. Instead Originator paid by a funds transfer to Beneficiary's account in Bank B. Bank B accepted a payment order for the benefit of Beneficiary by immediately notifying Beneficiary that the funds were available for withdrawal. Before Beneficiary had a reasonable opportunity to withdraw the funds Bank B suspended payments. Under the unless clause of subsection (b) Beneficiary is not required to accept the payment as discharging the obligation owed by Originator to Beneficiary if Beneficiary's contract means that Beneficiary was not required to accept payment by wire transfer. Beneficiary could refuse the funds transfer as payment of the obligation and could resort to rights under the underlying contract to enforce the obligation. The rationale is that Originator cannot impose the risk of Bank B's insolvency on Beneficiary if Beneficiary had specified another means of payment that did not entail that risk. If Beneficiary is required to accept Originator's payment, Beneficiary would suffer a loss that would not have occurred if payment had been made by a cashier's check on Bank A, and Bank A has not suspended payments. In this case Originator will have to pay twice. It is obliged to pay the amount of its payment order to the bank that accepted it and has to pay the obligation it owes to Beneficiary which has not been discharged. Under the last sentence of subsection (b) Originator is subrogated to Beneficiary's right to receive payment from Bank B under Section 4A-404(a).

4. Suppose Beneficiary's contract called for payment by a Fedwire transfer to Bank B, but the payment order accepted by Bank B was not a Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank B suspended payments. The sender of the payment order to Bank B paid the amount of the order to Bank B. In this case the payment order by Originator did not comply with Beneficiary's contract, but the noncompliance did not result in a loss to Beneficiary as required by subsection (b)(iv). A Fedwire transfer avoids the risk of insolvency of the sender of the payment order to Bank B, but it does not affect the risk that Bank B will suspend payments before withdrawal of the funds by Beneficiary. Thus, the unless clause of subsection (b) is not applicable and the obligation owed to Beneficiary is discharged.

5. Charges of receiving banks in a funds transfer normally are nominal in relationship to the amount being paid by the originator to the beneficiary. Wire transfers are normally agreed to in advance and the parties may agree concerning how these charges are to be divided between the parties. Subsection (c) states a rule that applies in the absence of agreement. In some funds transfers charges of banks that execute payment orders are collected by deducting the charges from the amount of the payment order issued by the bank, i.e. the bank issues a payment order that is slightly less than the amount of the payment order that is being executed. The process is described in Comment 3 to Section 4A-302. The result in such a case is that the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's order. Subsection (c) recognizes the principle that a beneficiary is entitled to full payment of a debt paid by wire transfer as a condition to discharge. On the other hand, subsection (c) prevents a beneficiary from denying the originator the benefit of the payment by asserting that discharge did not occur because deduction of bank charges resulted in less than full payment. The typical case is one in which the payment is made to exercise a valuable right such as an option which is unfavorable to the beneficiary. Subsec-

tion (c) allows discharge notwithstanding the deduction unless the originator fails to reimburse the beneficiary for the deducted charges after demand by the beneficiary.

PART 5.

MISCELLANEOUS PROVISIONS.

§ 25-4A-501. Variation by agreement and effect of funds-transfer system rule.

(a) Except as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) "Funds-transfer system rule" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in G.S. 25-4A-404(c), 25-4A-405(d), and 25-4A-507(c). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section is designed to give some flexibility to Article 4A. Funds transfer system rules govern rights and obligations between banks that use the system. They may cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank. Funds transfer system rules can be very effective in supplementing the provisions of Article 4A and in filling gaps that may be present in Article 4A. To the extent they do not conflict with Article 4A there is no problem with respect to their effectiveness. In that case they merely supplement Article 4A. Section 4A-501 goes further. It states that unless the contrary is stated, funds transfer system rules can override provisions of Article 4A. Thus, rights and obligations of a sender bank and a receiving bank with respect to each other can be different from that stated in Article 4A to the extent a funds transfer system rule applies. Since funds transfer system rules are defined as those governing the relationship between participating banks, a rule can have have a direct effect only on participating banks. But a rule that affects the conduct of a participating bank may indirectly affect the rights of nonparticipants such as the originator or beneficiary of a funds transfer, and such a rule can be effective even though it may affect nonparticipants without their consent. For example, a rule might prevent execution of a payment order or might allow cancellation of a payment order with the result that a funds transfer is not completed or is delayed. But a rule purporting to define rights and obligations of nonparticipants in the system would not be effective to alter Article 4A rights because the rule is not within the definition of funds transfer system rule. Rights and obligations arising under Article 4A may also be varied by agreement of the affected parties, except to the extent Article 4A otherwise provides. Rights and obligations arising under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A-107.

2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH transfer is made through an automated clearing house of a Federal Reserve Bank or through an automated clearing house of another association of banks, the rights and obligations of the originator's bank and the beneficiary's bank are governed by uniform rules adopted by various associations of banks in various parts of the nation. With respect to transfers in which a Federal Reserve Bank acts

as intermediary bank these rules may be incorporated, in whole or in part, in operating circulars of the Federal Reserve Bank. Even if not so incorporated these rules can still be binding on the association banks. If a transfer is made through a Federal Reserve Bank, the rules are effective under subsection (b)(ii). If the transfer is not made through a Federal Reserve Bank, the association rules are effective under subsection (b)(i).

§ 25-4A-502. Creditor process served on receiving bank; setoff by beneficiary's bank.

(a) As used in this section, "creditor process" means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(2) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(3) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. When a receiving bank accepts a payment order, the bank normally receives payment from the sender by debiting an authorized account of the sender. In accepting the sender's order the bank may be relying on a credit balance in the account. If creditor process is served on the bank with respect to the account before the bank accepts the order but the bank employee responsible for the acceptance was not aware of the creditor process at the time the acceptance occurred, it is unjust to the bank to allow the creditor process to take the credit balance on which the bank may have relied. Subsection (b) allows the bank to obtain payment form the sender's account in this case. Under that provision, the balance in the sender's account to which the creditor process applies is deemed to be reduced by the amount of the payment order unless there was sufficient time for notice of the service of creditor process to be received by personnel of the bank responsible for the acceptance.

2. Subsection (c) deals with payment orders issued to the beneficiary's bank. The bank may credit the beneficiary's account when the order is received, but under Section 4A-404(a) the bank incurs no obligation to pay the beneficiary until the order is accepted pursuant to Section 4A-209(b). Thus, before acceptance, the credit to the beneficiary's account is provisional. But

under Section 4A-209(b) acceptance occurs if the beneficiary's bank pays the beneficiary pursuant to Section 4A-405(a). Under that provision, payment occurs if the credit to the beneficiary's account is applied to a debt of the beneficiary. Subsection (c)(1) allows the bank to credit the beneficiary's account with respect to a payment order and to accept the order by setting off the credit against an obligation owed to the bank or applying the credit to creditor process with respect to the account.

Suppose a beneficiary's bank receives a payment order for the benefit of a customer. Before the bank accepts the order, the bank learns that creditor process has been served on the bank with respect to the customer's account. Normally there is no reason for a beneficiary's bank to reject a payment order, but if the beneficiary's account is garnished, the bank may be faced with a difficult choice. If it rejects the order, the garnishing creditor's potential recovery of funds of the beneficiary is frustrated. It may be faced with a claim by the creditor that the rejection was a wrong to the creditor. If the bank accepts the order, the effect is to allow the creditor to seize funds of its customer, the beneficiary. Subsection (c)(3) gives the bank no choice in this case. It provides that it may not favor its customer over the creditor by rejecting the order. The beneficiary's bank may rightfully reject only if there is an independent basis for rejection.

3. Subsection (c)(2) is similar to subsection (b). Normally the beneficiary's bank will release funds to the beneficiary shortly after acceptance or it will accept by releasing funds. Since the bank is bound by a garnishment order served before funds are released to the beneficiary, the bank might suffer a loss if funds were released without knowledge that a garnishment order had been served. Subsection (c)(2) protects the bank if it did not have adequate notice of the garnishment when the funds were released.

4. A creditor may want to reach funds involved in a funds transfer. The creditor may try to do so by serving process on the originator's bank, an intermediary bank or the beneficiary's bank. The purpose of subsection (d) is to guide the creditor and the court as to the proper method of reaching the funds involved in a funds transfer. A creditor of the originator can levy on the account of the originator in the originator's bank before the funds transfer is initiated, but that levy is subject to the limitations stated in subsection (b). The creditor of the originator cannot reach any other funds because no property of the originator is being transferred. A creditor of the beneficiary cannot levy on property of the originator and until the funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary, the beneficiary has no property interest in the funds transfer which the beneficiary's creditor can reach. A creditor of the beneficiary that wants to reach the funds to be received by the beneficiary must serve creditor process on the beneficiary's bank to reach the obligation of the beneficiary's bank to pay the beneficiary which arises upon acceptance by the beneficiary's bank under Section 4A-404(a).

5. "Creditor process" is defined in subsection (a) to cover a variety of devices by which a creditor of the holder of a bank account or a claimant to a bank account can seize the account. Procedure and nomenclature varies widely from state to state. The term used in Section 4A-502 is a generic term.

§ 25-4A-503. Injunction or restraining order with respect to funds transfer.

For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is related to Section 4A-502(d) and to Comment 4 to Section 4A-502. It is designed to prevent interruption of a funds transfer after it has been set in motion. The initiation of a funds transfer can be prevented by enjoining the originator or the originator's bank from issuing a payment order. After the funds transfer is completed by acceptance of a payment order by the beneficiary's bank, that bank can be enjoined from releasing funds to the beneficiary or the beneficiary can be enjoined from withdrawing the funds. No other injunction is permitted. In particular, intermediary banks are protected, and injunctions against the originator and the originator's bank are limited to issuance of a payment order. Except for the beneficiary's bank, nobody can be enjoined from paying a payment order, and no receiving bank can be enjoined from receiving payment from the sender of the order that it accepted.

§ 25-4A-504. Order in which items and payment orders may be charged to account; order of withdrawals from account.

(a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) concerns priority among various obligations that are to be paid from the same account. A customer may have written checks on its account with the receiving bank and may have issued one or more payment orders payable from the same account. If the account balance is not sufficient to cover all of the checks and payment orders, some checks may be dishonored and some payment orders may not be accepted. Although there is no concept of wrongful dishonor of a payment order in Article 4A in the absence of an agreement to honor by the receiving bank, some rights and obligations may depend on the amount in the customer's account. Section 4A-209(b)(3) and Section 4A-210(b). Whether dishonor of a check is wrongful also may depend upon the balance in the customer's account. Under subsection (a), the bank is not required to consider the competing items and payment orders in any particular order. Rather it may charge the customer's account for the various items and orders in any order. Suppose there is $12,000 in the customer's account. If a check for $5,000 is presented for payment and the bank receives a $10,000 payment order from the customer, the bank could dishonor the check and accept the payment order. Dishonor of the check is not wrongful because the account balance was less than the amount of the check after the bank charged the account $10,000 on account of the payment order. Or, the bank could pay the check and not execute the payment order because the amount of the order is not covered by the balance in the account.

2. Subsection (b) follows Section 4-208(b) in using the first-in-first-out rule for determining the order in which credits to an account are withdrawn.

§ 25-4A-505. Preclusion of objection to debit of customer's account.

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is in the nature of a statute of repose for objecting to debits made to the customer's account. A receiving bank that executes payment orders of a customer may have received payment from the customer by debiting the customer's account with respect to a payment order that the customer was not required to pay. For example, the payment order may not have been authorized or verified pursuant to Section 4A-202 or the funds transfer may not have been completed. In either case the receiving bank is obliged to refund the payment to the customer and this obligation to refund payment cannot be varied by agreement. Section 4A-204 and Section 4A-402. Refund may also be required if the receiving bank is not entitled to payment from the customer because the bank erroneously executed a payment order. Section 4A-303. A similar analysis applies to that case. Section 4A-402(d) and (f) require refund and the obligation to refund may not be varied by agreement. Under 4A-505, however, the obligation to refund may not be asserted by the customer if the customer has not objected to the debiting of the account within one year after the customer received notification of the debit.

§ 25-4A-506. Rate of interest.

(a) If, under this Article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in subsection (a), the amount is calculated by multiplying the applicable federal funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable federal funds rate is the average of the federal funds rates published by the Federal Reserve Bank of New York for each of the days for which interest is payable divided by 360. The federal funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. A receiving bank is required to pay interest on the amount of a payment order received by the bank in a number of situations. Sometimes the interest is payable to the sender and in other cases it is payable to either the originator or the beneficiary of the funds transfer. The relevant provisions are Section 4A-204(a), Section 4A-209(b)(3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section 4A-404(b). The rate of interest may be governed by a funds transfer system rule or by agreement as stated in subsection (a). If subsection (a) doesn't apply, the rate is determined under subsection (b). Subsection (b) is illustrated by the following example. A bank is obliged to pay interest on $1,000,000 for three days, July 3, July 4, and July 5. The published Fed Funds rate is .082 for July 3 and .081 for July 5. There is no published rate for July 4 because that day is not a banking day. The rate for July 3 applies to July 4. The applicable Fed Funds rate is .08167 (the average of .082, .082, and .081) divided by 360 which equals .0002268. The amount of interest payable is $1,000,000 X .0002268 X 3 = $680.40.

2. In some cases, interest is payable in spite of the fact that there is no fault by the receiving bank. The last sentence of subsection (b) applies to those cases. For example, a funds transfer might not be completed because the beneficiary's bank rejected the payment order issued to it by the originator's bank or an intermediary bank. Section 4A-402(c) provides that the originator is not obliged to pay its payment order and Section 4A-402(d) provides that the originator's bank must refund any payment received plus interest. The requirement to pay interest in this case is not based on fault by the originator's bank. Rather, it is based on restitution. Since the originator's bank had the use of the originator's money, it is required to pay the originator for the value of that use. The value of that use is not determined by multiplying the interest rate by the refundable amount because the originator's bank is required to deposit with the Federal Reserve a percentage of the bank's deposits as a reserve requirement. Since that deposit does not bear interest, the bank had use of the refundable amount reduced by a percentage equal to the reserve requirement. If the reserve requirement is 12%, the amount of interest

payable by the bank under the formula stated in subsection (b) is reduced by 12%.

§ 25-4A-507. Choice of law.

(a) The following rules apply unless the affected parties otherwise agree or subsection (c) applies:

(1) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(2) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(3) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of subsection (a) have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to clause (i) is binding on participating banks. A choice of law made pursuant to clause (ii) is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under subsection (b) and a choice-of-law rule under subsection (c), the agreement under subsection (b) prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Funds transfers are typically interstate or international in character. If part of a funds transfer is governed by Article 4A and another part is governed by other law, the rights and obligations of parties to the funds transfer may be unclear because there is no clear consensus in various jurisdictions concerning the juridical nature of the transaction. Unless all of a funds transfer is governed by a single law it may be very difficult to predict the result if something goes wrong in the transfer. Section 4A-507 deals with this problem. Subsection (b) allows parties to a funds transfer to make a choice-of-law agreement. Subsection (c) allows a funds transfer system to select the law of a particular jurisdiction to govern funds transfers carried out by means of the system. Subsection (a) states residual rules if no choice of law has occurred under subsection (b) or (c).

2. Subsection (a) deals with three sets of relationships. Rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located. If the

receiving bank is the beneficiary's bank the rights and obligations of the beneficiary are also governed by the law of the jurisdiction in which the receiving bank is located. Suppose Originator, located in Canada, sends a payment order to Originator's Bank located in a state in which Article 4A has been enacted. The order is for payment to an account of Beneficiary in a bank in England. Under subsection (a)(1), the rights and obligations of Originator and Originator's Bank toward each other are governed by Article 4A if an action is brought in a court in the Article 4A state. If an action is brought in a Canadian court, the conflict of laws issue will be determined by Canadian law which might or might not apply the law of the state in which Originator's Bank is located. If that law is applied, the execution of Originator's order will be governed by Article 4A, but with respect to the payment order of Originator's Bank to the English bank, Article 4A may or may not be applied with respect to the rights and obligations between the two banks. The result may depend upon whether action is brought in a court in the state in which Originator's Bank is located or in an English court. Article 4A is binding only on a court in a state that enacts it. It can have extraterritorial effect only to the extent courts of another jurisdiction are willing to apply it. Subsection (c) also bears on the issues discussed in this Comment.

Under Section 4A-406 payment by the originator to the beneficiary of the funds transfer occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. A jurisdiction in which Article 4A is not in effect may follow a different rule or it may not have a clear rule. Under Section 4A-507(a)(3) the issue is governed by the law of the jurisdiction in which the beneficiary's bank is located. Since the payment to the beneficiary is made through the beneficiary's bank it is reasonable that the issue of when payment occurs be governed by the law of the jurisdiction in which the bank is located. Since it is difficult in many cases to determine where a beneficiary is located, the location of the beneficiary's bank provides a more certain rule.

3. Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties. With respect to commercial transactions, it is often said that "[u]niformity and predictability based upon commercial convenience are the prime considerations in making the choice of governing law ...." R. Leflar, American Conflicts Law, G.S. 185 (1977). Subsection (b) is derived in part from recently enacted choice-of-law rules in the States of New York and California. N.Y. Gen. Obligations Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code G.S. 1646.5. This broad endorsement of freedom of contract is an enhancement of the approach taken by Restatement (Second) of Conflict of Laws G.S. 187(b) (1971). The Restatement recognizes the basic right of freedom of contract, but the freedom granted the parties may be more limited than the freedom granted here. Under the formulation of the Restatement, if there is no substantial relationship to the jurisdiction whose law is selected and there is no "other" reasonable basis for the parties' choice, then the selection of the parties need not be honored by a court. Further, if the choice is violative of a fundamental policy of a state which has a materially greater interest than the chosen state, the selection could be disregarded by a court. Those limitations are not found in subsection (b).

4. Subsection (c) may be the most important provision in regard to creating uniformity of law in funds transfers. Most rights stated in Article 4A regard parties who are in privity of contract such as originator and beneficiary, sender and receiving bank, and beneficiary's bank and beneficiary. Since they are in privity they can make a choice of law by agreement. But that is not always the case. For example, an intermediary bank that improperly executes a payment order is not in privity with either the originator or the beneficiary. The ability of a funds transfer system to make a choice of law by rule is a convenient way of dispensing with individual agreements and to cover cases in which agreements are not feasible. It is probable that funds transfer systems will adopt a governing law to increase the certainty of commercial transactions that are effected over such systems. A system rule might adopt the law of an Article 4A state to govern transfers on the system in order to provide a consistent, unitary, law governing all transfers made on the system. To the extent such system rules develop, individual choice-of-law agreements become unnecessary.

Subsection (c) has broad application. A system choice of law applies not only to rights and obligations between banks that use the system, but may also apply to other parties to the funds transfer so long as some part of the transfer was carried out over the system. The originator and any other sender or receiving bank in the funds transfer is bound if at the time it issues or accepts a payment order it had notice that the funds transfer involved use of the system and that the system chose the law of a particular jurisdiction. Under Section 4A-107, the Federal Reserve by regulation could make a similar choice of law to govern funds transfers carried out by use of Federal Reserve Banks. Subsection (d) is a limitation on subsection (c).

If parties have made a choice-of-law agreement that conflicts with a choice of law made under subsection (c), the agreement prevails.

5. Subsection (e) addresses the case in which a funds transfer involves more than one funds transfer system and the systems adopt conflicting choice-of-law rules. The rule that has the most significant relationship to the matter at issue prevails. For example, each system should be able to make a choice of law governing payment orders transmitted over that system without regard to a choice of law made by another system.

ARTICLE 5.

Letters Of Credit.

(Revised)

NORTH CAROLINA COMMENT

This Article is based upon Revised Article 5 of the Uniform Commercial Code (hereinafter "Revised Article 5").

Two types of comments appear. Under the designation "OFFICIAL COMMENT" are the Official Comments of the National Conference of Commissioners on Uniform State Laws. Under the designation "NORTH CAROLINA COMMENT" are comments designed to note North Carolina deviations from Revised Article 5. Therefore, only sections that deviate from Revised Article 5 have a North Carolina Comment.

Editor's Note. — Session Laws 1999-73, s. 1, effective October 1, 1999, rewrote Article 5 of Chapter 25 of the Uniform Commercial Code. Case annotations to sections in the former Article 5 have been added to corresponding sections in the new Article 5 as recodified. At the end of Article 5 are tables showing comparable sections and their disposition in new Article 5.

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§ 25-5-101. Short title.

This article may be cited as Uniform Commercial Code — Letters of Credit. (1999-73, s. 1.)

OFFICIAL COMMENT

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5, but in certain circumstances they will override Article 5.

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For article, "Letters Of Credit: A North Carolina Primer," see 24 Wake Forest L. Rev. 653 (1989).

§ 25-5-102. Definitions.

(a) In this Article:

(1) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) "Dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in G.S. 25-5-108(e) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "Good faith" means honesty in fact in the conduct or transaction concerned.

(8) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs:
   a. Upon payment;
   b. If the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment; or
   c. If the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(10) "Letter of credit" means a definite undertaking that satisfies the requirements of G.S. 25-5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(11) "Nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(12) "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(13) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other Articles of this Chapter applying to this Article and the sections in which they appear are:

"Accept" or "Acceptance" G.S. 25-3-409.

"Value" G.S. 25-3-303, G.S. 25-4-209.

(c) Article 1 of this Chapter contains certain additional general definitions and principles of construction and interpretation applicable throughout this Article. (1999-73, s. 1.)

OFFICIAL COMMENT

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmer" for its own account or as guarantees or contracts outside of Article 5.

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition — which does not include "fair dealing" — is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and issuers with an "unfairness" defense to dishonor even when the documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d)) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, G.S. 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(c)) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking" as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot be an issuer where that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's

failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank, 493 F.2d 1285 (9th Cir. 1974).

The adjective "definite" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., Transparent Products Corp. v. Paysaver Credit Union, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit," but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the "successor of a beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is "by operation of law" — such as the sale of assets by one company to another.

11. "Draft" in Article 5 does not have the same meaning it has in Article 3. For example, a document may be a draft under Article 5 even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e).

CASE NOTES

***Editor's Note.** — The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1999 revision.*

Nature of Letter of Credit. — Since the letter of credit is essentially a contract between the issuer and the beneficiary, it is recognized by this Article as being independent of the underlying contract between the customer and the beneficiary. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Stipulation Held Agreement to Agree Rather Than Guaranty. — Stipulation provision entered into in exchange for plaintiffs banks' consent to stay foreclosure, which stated that defendant bank would issue a standby letter of credit in favor of plaintiffs, as beneficiaries, was a mere agreement to agree, rather than an enforceable contract of guaranty, where until defendant's issuer and principals the mortgagors formed underlying preliminary contract, no letter of credit contract could issue, and the provision left open and unsettled the future formation of the requisite preliminary contract between defendant and mortgagors, and provided no mode of ensuring execution thereof. Mountain Fed. Land Bank v. First Union Nat'l Bank, 98 N.C. App. 195, 390 S.E.2d 679, cert. denied, 327 N.C. 141, 394 S.E.2d 178 (1990).

§ 25-5-103. Scope.

(a) This Article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this Article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this Article.

(c) With the exception of this subsection, subsections (a) and (d) of this section, G.S. 25-5-102(a)(9) and (10), 25-5-106(d), and 25-5-114(d), and except to the extent prohibited in G.S. 25-1-302 and G.S. 25-5-117(d), the effect of this Article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this Article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary. (1999-73, s. 1; 2006-112, s. 19.)

OFFICIAL COMMENT

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that

properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(3) and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

Effect of Amendments. — Session Laws 2006-112, s. 19, effective October 1, 2006, substituted "G.S. 25-1-302" for "G.S. 25-1-102(3)" in subsection (c).

CASE NOTES

***Editor's Note.** — The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1999 revision.*

The letter of credit is a contract. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

And Is Separate from Underlying Contract. — Credits, by their nature, are separate transactions from the sales or other contracts on which they may be based, and banks are in no way concerned with or bound by such contracts. Sunset Inv., Ltd. v. Sargent, 52 N.C. App. 284, 278 S.E.2d 558, cert. denied, 303 N.C. 550, 281 S.E.2d 401 (1981).

The basic aspect of the successful use of letters of credit lies in recognizing at the threshold that every letter of credit involves separate and distinct contracts; and that the contract between the issuing bank and the beneficiary to pay money to the beneficiary upon demand (and documentation if called for) must be kept chaste — independent of the underlying contract between the purchaser of the letter and the beneficiary. Sunset Inv., Ltd. v. Sargent, 52 N.C. App. 284, 278 S.E.2d 558, cert. denied, 303 N.C. 550, 281 S.E.2d 401 (1981).

Stipulation Held Agreement to Agree Rather Than Enforceable Guaranty. — Stipulation provision entered into in exchange for plaintiff banks' consent to stay foreclosure, which stated that defendant bank would issue a standby letter of credit in favor of plaintiffs, as beneficiaries, was a mere agreement to agree, rather than an enforceable contract of guaranty, where until defendant's issuer and principals, the mortgagors, formed underlying preliminary contract, no letter of credit contract could issue, and the provision left open and unsettled the future formation of the requisite preliminary contract between defendant and mortgagors, and provided no mode of ensuring execution thereof. Mountain Fed. Land Bank v. First Union Nat'l Bank, 98 N.C. App. 195, 390 S.E.2d 679, cert. denied, 327 N.C. 141, 394 S.E.2d 178 (1990).

§ 25-5-104. Formal requirements.

A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in G.S. 25-5-108(e). (1999-73, s. 1.)

OFFICIAL COMMENT

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser.

An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

§ 25-5-105. Consideration.

Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation. (1999-73, s. 1.)

OFFICIAL COMMENT

It is not to be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in Pillans v. Van Mierop, 97 Eng.Rep. 1035 (K.B. 1765) in making consideration irrelevant.

§ 25-5-106. Issuance, amendment, cancellation, and duration.

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued. (1999-73, s. 1.)

OFFICIAL COMMENT

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., Weyerhaeuser Co. v. First Nat. Bank, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); West Va. Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."

§ 25-5-107. Confirmer, nominated person, and adviser.

(a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant, and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c) of this section. The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies. (1999-73, s. 1.)

OFFICIAL COMMENT

1. A confirmer has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms "confirmer" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of Sound of Market Street v. Continental Bank International, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

§ 25-5-108. Issuer's rights and obligations.

(a) Except as otherwise provided in G.S. 25-5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e) of this section, appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in

G.S. 25-5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) To honor;

(2) If the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation; or

(3) To give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d) of this section, an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) of this section or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor (i) fraud or forgery as described in G.S. 25-5-109(a) or (ii) expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) The performance or nonperformance of the underlying contract, arrangement, or transaction;

(2) An act or omission of others; or

(3) Observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e) of this section.

(g) If an undertaking constituting a letter of credit under G.S. 25-5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this Article:

(1) Is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) Takes the documents free of claims of the beneficiary or presenter;

(3) Is precluded from asserting a right of recourse on a draft under G.S. 25-3-414 and G.S. 25-3-415;

(4) Except as otherwise provided in G.S. 25-5-110 and G.S. 25-5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) Is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged. (1999-73, s. 1.)

OFFICIAL COMMENT

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in Banco Español de Credito v. State Street Bank and Trust Company, 385 F.2d 230 (1st Cir. 1967) and Flagship Cruises Ltd. v. New England Merchants Nat. Bank, 569 F.2d 699 (1st Cir. 1978). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in New Braunfels Nat. Bank v. Odiorne, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on "Letter of Credit No. 86-122-5"and letter of credit specified "Letter of Credit No. 86-122-S" holding strict compliance does not demand oppressive perfectionism). The section also indorses the result in Tosco Corp. v. Federal Deposit Insurance Corp., 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as American Coleman Co. v. Intrawest Bank, 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-103(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable

time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time would be less than seven days. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111, irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106.

The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made.

Failure of the issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in Flagship Cruises Ltd. v. New England Merchants' Nat. Bank, 569 F.2d 699 (1st Cir. 1978) and Wing On Bank Ltd. v. American Nat. Bank & Trust Co., 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of Flagship and Wing On, the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as Datapoint Corp. v. M & I Bank, 665 F. Supp. 722 (W.D. Wis. 1987) and Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank, 710 F. Supp. 275 (D. Ore. 1989).

The section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank," or as an "acceptor" or "accepting bank," in other cases as a "negotiating bank," and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated person or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law. A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of Courtaulds of North America Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in Schweibish v. Pontchartrain State Bank, 389 So.2d 731 (La.App. 1980) and Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4).

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like Pringle-Associated Mortgage Corp. v. Southern National Bank, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as Sherwood & Roberts, Inc. v. First Security Bank, 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting "shipment on vessels more than 15 years old," are to be disregarded and treated as surplusage. Similarly, a requirement that there be an award by a "duly appointed arbitrator" would not require the issuer to determine whether the arbitrator had been "duly appointed." Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) condones an issuer's ignorance of "any usage of a particular trade"; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a).

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

CASE NOTES

Editor's Note. *— The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1999 revision.*

Drawee bank is involved only with documents, not with merchandise. Its involvement is altogether separate and apart from the transaction between the buyer and seller; its duties and liability are governed exclusively by the terms of the letter, not the terms of the parties' contract with each other. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802 (4th Cir. 1975).

Drawee bank is not to be embroiled in disputes between buyer and seller, the beneficiary of the credit. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802 (4th Cir. 1975).

The legal standard which the issuer is required to meet in order to avoid liability is one requiring a careful examination of the documents to determine if they are regular on their face. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

When an issuer discovers a possible discrepancy, it is incumbent upon it to disclose that fact to the beneficiary as soon as reasonably possible so as to not waive the issuer's right to demand strict compliance with the terms of the credit. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

An issuer bank is bound by a promise in a letter of credit, which may be enforced by a person acting in strict compliance and on good faith thereof, and the bank cannot escape liability because of the insolvency of the person to whom the letter is addressed or the customer. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

Beneficiary Must Meet Terms of Credit to Recover from Drawee Bank. — The beneficiary must meet the terms of the credit — and precisely — if it is to exact performance of the issuer. Failing such compliance there can be no recovery from the drawee bank. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802 (4th Cir. 1975).

A commercial letter of credit is essentially a third-party beneficiary contract by which a party wishing to transact business induces a bank to issue the letter to a third party. It is a contract between the procuring customer and the issuing bank for the benefit of the payee-beneficiary. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

It Is Independent of Contract Between Customer and Beneficiary. — Since the letter of credit is essentially a contract between the issuer and the beneficiary, it is recognized by this Article as being independent of the underlying contract between the customer and the beneficiary. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

When Draft Must Be Honored. — In the event the documents appear regular on their face and the documentary demand for payment complies with the terms of the credit, the issuer must honor the draft. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

With limited exceptions, this section imposes on the issuer a duty to honor drafts where there has been compliance with the terms of credit. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

A bank's duty to honor arises only when the demand for payment complies with the relevant credit. Dubose Steel, Inc. v. Branch Banking & Trust Co., 72 N.C. App. 598, 324 S.E.2d 859, cert. denied, 314 N.C. 115, 332 S.E.2d 480 (1985).

One reason given for the issuer's stringent duty to honor in spite of alleged infirmities in the underlying contract is that one of the basic purposes of the letter of credit is to eliminate the risk to the beneficiary that the customer will refuse or halt payment because of alleged deficiencies in the beneficiary's performance. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

When an issuer discovers a possible discrepancy, it is incumbent upon it to disclose that fact to the beneficiary as soon as reasonably possible so as to not waive the issuer's right to demand strict compliance with the terms of the credit. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

All Required Documents Must Be as Stated in Letter of Credit. — A bank is interested only in the documents to be presented and, therefore, the essential requirements of a letter of credit must be strictly complied with by the party entitled to draw against the letter of credit. This means all required documents must be as stated in the letter. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

An issuer bank is bound by a promise in a letter of credit, which may be enforced by a person acting in strict compliance and on good faith thereof, and the bank cannot escape liability because of the insolvency of the person to whom the letter is addressed or the customer. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92 (M.D.N.C. 1975), rev'd on other grounds, 528 F.2d 802 (4th Cir. 1975).

Exceptions to Issuer's Duty Concern Genuineness of Documents. — The exceptions to the issuer's duty to honor documents which on their face comply with the terms of the credit concern merely the genuineness of the documents presented for honor. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

When Payment of Draft May Be Enjoined. — Given the independence of the issuer's obligation to the beneficiary, and the commercial purposes which this independent obligation serves, it would appear that an injunction should issue to enjoin payment of a draft only in those instances where there is some action by the beneficiary which vitiates the transaction between the beneficiary and the issuer. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Since the transaction between the beneficiary and the issuer is one consisting of an exchange of documents, only some defect in these documents would justify an injunction against honor. Subsection (2) of former G.S. 25-5-114 spoke (now see this section) to those defects in documents which are not apparent on the face of the documents, and permits dishonor or the issue of an injunction only in situations where the documents presented are themselves the product of some sort of fraud. Accordingly, the beneficiary's fraud on the customer in the inducement of their separate contract would not justify dishonor or an injunction, nor would a breach of warranty or defect in the quality of the goods delivered pursuant to the underlying contract, for these defects are not of the sort which relate to the contract between the issuer and beneficiary. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Beneficiary's Right Not Affected by Requirement Which Was Not a Term of Letter of Credit. — While the beneficiary must strictly comply with the terms of a letter of credit in order to make a demand from the issuer, where plaintiff beneficiary complied with terms of letter of credit, and delivered required certified statement to issuer, any requirement of demand on customers was not a term of the letter of credit and did not affect plaintiff beneficiary's right to present a draft on the letter of credit. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

§ 25-5-109. Fraud and forgery.

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) The issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) The issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) The relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) A beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) All of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) On the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subdivision (a)(1) of this section. (1999-73, s. 1.)

OFFICIAL COMMENT

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See Cromwell v. Commerce & Energy Bank, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in Intraworld Indus. v. Girard Trust Bank, 336 A.2d 316 (Pa. 1975), Roman Ceramics Corp. v. People's Nat. Bank, 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in Ground Air Transfer v. Westate's

Airlines, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

> We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," Itek, 730 F.2d at 25 (quoting Roman Ceramics Corp. v. Peoples National Bank, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); then a court may enjoin payment.

2. Subsection (a)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in Griffin Cos. v. First Nat. Bank, 374 N.W.2d 768 (Minn.App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8)) in the particular letter of credit to occur upon acceptance and without regard to later payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance — whether or not the acceptance constitutes honor.

5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see Ground Air Transfer Inc. v. Westates Airlines, Inc., 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against — by bond or otherwise under subsection (b)(2) — includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

Legal Periodicals. — For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

CASE NOTES

Editor's Note. — *The cases cited below were decided under this Article of the Uniform Commercial Code prior to its 1999 revision.*

"Fraud in the transaction" refers to the beneficiary's accompanying his draft with documents or declarations which have absolutely no basis in the facts of the underlying performance. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

A "fraudulent" document presumably is one that is completely forged or drawn up without any underlying basis in fact, one that is but partly spurious or a document which has been materially altered. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Fraudulent Attachment of Letter of Credit to Negotiable Instrument as Security. — The knowing and intentional attachment of a guaranty letter of credit, as collateral security, to a negotiable instrument which that letter was not intended to secure, and the eventual presentation of these documents to the issuing bank for purposes of honor of the letter of credit, would amount to a presentation of fraudulent documents. In such a case, though the note may be valid as against other parties to the note, the documents, considered as a whole, are nonetheless fraudulent insofar as the letter of credit was not intended to secure that particular note, and the beneficiary had knowledge of this fact. O'Grady v. First Union Nat'l Bank, 296 N.C. 212, 250 S.E.2d 587 (1978).

Knowledge on Part of Beneficiary of Fraudulent Procurement of Letter of Credit. — It may be argued that where a beneficiary extends a loan relying on a letter of credit which he knows was procured through fraud on the issuer, the statement of default of the underlying loan is a product of the fraud entitling the issuer to one of the exceptions to the issuer's duty to honor. However, the beneficiary must have known of the fraudulent procurement of the letter of credit at the time it extended credit based on the letter as collateral. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

§ 25-5-110. Warranties.

(a) If its presentation is honored, the beneficiary warrants:

(1) To the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in G.S. 25-5-109(a); and

(2) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in subsection (a) of this section are in addition to warranties arising under Articles 3, 4, 7, and 8 of this Chapter because of the presentation or transfer of documents covered by any of those Articles. (1999-73, s. 1.)

OFFICIAL COMMENT

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due perfor-

mance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases — where the damages usually equal the amount of the draw — the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a default of $200,000 and a draw of $500,000. The damages for breach of warranty would be no more than $300,000.

§ 25-5-111. Remedies.

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches an obligation under this Article or an issuer breaches an obligation not covered in subsection (a) or (b) of this section, a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (a) and (b) of this section.

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) of this section shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorneys' fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this Article, and G.S. 6-21.2 shall not apply.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this Article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated. (1999-73, s. 1.)

OFFICIAL COMMENT

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages — at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. Doelger v. Battery Park Bank, 201 A.D. 515, 194 N.Y.S. 582 (1922) and Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria, 497 F.Supp. 893 (S.D.N.Y. 1980), aff'd, 647 F.2d 300 (2d Cir. 1981), cert. denied, 454 U.S. 1148 (1982). The last sentence of subsection (c) does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107.

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. What damages "result" from improper honor is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at $100 per ton, but, upon delivery, the market value of conforming goods has decreased to $25 per ton. If the issuer pays over discrepancies, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $100 per ton for goods now worth $25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was

broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a). On the other hand a confirming bank that broke its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-111. Neither an issuer nor a confirmer should be treated as a "losing" party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly neither should be liable for fees and expenses in that case.

"Expenses of litigation" is intended to be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) "harm anticipated" must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504.

NORTH CAROLINA COMMENT

Subsection (e) of the Uniform Act is modified by inserting the phrase ", and G.S. 6-21.2 shall not apply".

§ 25-5-112. Transfer of letter of credit.

(a) Except as otherwise provided in G.S. 25-5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) The transfer would violate applicable law; or

(2) The transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in G.S. 25-5-108(e) or is otherwise reasonable under the circumstances. (1999-73, s. 1.)

OFFICIAL COMMENT

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP (which make elaborate provision for partial transfer of a commercial letter of credit) or

similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

"Transfer" of a letter of credit should be distinguished from "assignment of proceeds." The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant may lose control over the identity of the person whose performance will earn payment under the letter of credit.

§ 25-5-113. Transfer by operation of law.

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e) of this section, an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in G.S. 25-5-108(e) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under subsection (a) or (b) of this section has the consequences specified in G.S. 25-5-108(i) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of G.S. 25-5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) of this section or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b) of this section.

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section. (1999-73, s. 1.)

OFFICIAL COMMENT

This section affirms the result in Pastor v. Nat. Republic Bank of Chicago, 76 Ill.2d 139, 390 N.E.2d 894 (Ill. 1979) and Federal Deposit Insurance Co. v. Bank of Boulder, 911 F.2d 1466 (10th Cir. 1990).

An issuer's requirements for recognition of a successor's status might include presentation of a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of a beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

§ 25-5-114. Assignment of proceeds.

(a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 of this Chapter or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 of this Chapter or other law. (1999-73, s. 1.)

OFFICIAL COMMENT

1. Subsection (b) expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage — "assignment of proceeds" — to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "'proceeds' of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds of a letter of credit, subsections (c) and (d) follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has been received, issuers normally have required signatures on a consent form. This practice is reflected in the revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e), to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

§ 25-5-115. Statute of limitations.

An action to enforce a right or obligation arising under this Article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. (1999-73, s. 1.)

OFFICIAL COMMENT

1. This section is based upon Sections 4-111 and 2-725(2).

2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this article, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).

3. The statute of limitations, like the rest of

the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

§ 25-5-116. Choice of law and forum.

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in G.S. 25-5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) of this section applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this Article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b) of this section, (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this Article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in G.S. 25-5-103(c).

(d) If there is conflict between this Article and Article 3, 4, 4A, or 9 of this Chapter, this Article governs.

(e) Notwithstanding G.S. 22B-3, the forum for settling disputes arising out of an undertaking within this Article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a) of this section. (1999-73, s. 1.)

OFFICIAL COMMENT

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law — in the absence of agreement — even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the States of the United States renvoi will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of

law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the "liability of an applicant." However, subsection (b) does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the "liability of an issuer, nominated person, or adviser," subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized — at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a practice provision purported to free a party from any liability unless it were "grossly negligent" or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

Even though Article 5 is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5's revision, or with other practices that may develop. Rules of practice incorporated in the letter of credit or other undertaking are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. For example, "draft" is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4.

5. Subsection (e) must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not including letter of credit disputes, subsection (e) does not authorize parties to choose that forum. For example, the parties' agreement under Section 5-116(e) would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) and if — because of other law — that forum will not take jurisdiction, the parties' agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for the clause will take jurisdiction — the former in disregard of the clause and the latter in honor of the clause.

NORTH CAROLINA COMMENT

Subsection (e) of the Uniform Act is modified by inserting the phrase "Notwithstanding G.S. 22B-3,".

§ 25-5-117. Subrogation of issuer, applicant, and nominated person.

(a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a) of this section.

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) The issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) The beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) The applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) of this section do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (c) of this section do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse. (1999-73, s. 1.)

OFFICIAL COMMENT

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation "were a secondary obligor." (The term "secondary obligor" refers to a surety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship G.S. 1 (1995).) If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are "independent" of the underlying obligation. If, for example, a secondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in Tudor Development Group, Inc. v. United States Fidelity and Guaranty, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.

§ 25-5-118. Security interest of issuer or nominated person.

(a) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a) of this section, the security interest continues and is subject to Article 9 of this Chapter, but:

(1) A security agreement is not necessary to make the security interest enforceable under G.S. 25-9-203(b)(3);

(2) If the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(3) If the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document. (2000-169, s. 18.)

OFFICIAL COMMENT (1999 ED.)

1. This section gives the issuer of a letter of credit or a nominated person thereunder an automatic perfected security interest in a "document" (as that term is defined in Section 5-102(a)(6)). The security interest arises only if the document is presented to the issuer or nominated person under the letter of credit and only to the extent of the value that is given. This security interest is analogous to that awarded to a collecting bank under Section 4-210. Subsection (b) contains special rules governing the security interest arising under this section. In all other respects, a security interest arising under this section is subject to Article 9. See Section 9-109. Thus, for example, a security interest arising under this section may give rise to a security interest in proceeds under Section 9-315.

2. Subsection (b)(1) makes a security agreement unnecessary to the creation of a security interest under this section. Under subsection (b)(2), a security interest arising under this section is perfected if the document is presented in a medium other than a written or tangible medium. Documents that are written and that are not an otherwise-defined type of collateral under Article 9 (e.g., an invoice or inspection certificate) may be goods, in which an issuer or nominated person could perfect its security interest by possession. Because the definition of document in Section 5-102(a)(6) includes records (e.g., electronic records) that may not be goods, subsection (b)(2) provides for automatic perfection (i.e., without filing or possession).

Under subsection (b)(3), if the document (i) is in a written or tangible medium, (ii) is not a certified security, chattel paper, a document of title, an instrument, or a letter of credit, and (iii) is not in the debtor's possession, the security interest is perfected and has priority over a conflicting security interest. If the document is a type of tangible collateral that subsection (b)(3) excludes from its perfection and priority rules, the issuer or nominated person must comply with the normal method of perfection (e.g., possession of an instrument) and is subject to the applicable Article 9 priority rules. Documents to which subsection (b)(3) applies may be important to an issuer or nominated person. For example, a confirmer who pays the beneficiary must be assured that its rights to all documents are not impaired. It will find it necessary to present all of the required documents to the issuer in order to be reimbursed. Moreover, when a nominated person sends documents to an issuer in connection with the nominated person's reimbursement, that activity is not a collection, enforcement, or disposition of collateral under Article 9.

One purpose of this section is to protect an issuer or nominated person from claims of a beneficiary's creditors. It is a fallback provision inasmuch as issuers and nominated persons frequently may obtain and perfect security interests under the usual Article 9 rules, and, in many cases, the documents will be owned by the issuer, nominated person, or applicant.

TABLES OF COMPARABLE SECTIONS FOR CHAPTER 25, REVISED ARTICLE 5

Former to Present

Editor's Note. — The following table shows G.S. sections from former Chapter 25, Article 5, and their comparable, new revised Chapter 25, Article 5 numbers. Where there is no comparable new number, the term "Omitted" has been inserted.

Former Section	Present Section
25-5-101	25-5-101
25-5-102(1)	25-5-103(a)
25-5-102(2)	Omitted
25-5-102(3)	25-5-103(b)
25-5-103	25-5-102
25-5-104	25-5-104, 25-5-102(6) and (14)
25-5-105	25-5-105
25-5-106	25-5-106(a) and (b)
25-5-107(1)	25-5-107(c)
25-5-107(2)	25-5-107(a)
25-5-107(3)	25-5-107(c)
25-5-107(4)	Omitted
25-5-108	Omitted
25-5-109(1)	25-5-108
25-5-109(2)	25-5-108
25-5-109(3)	Omitted
25-5-110	Omitted
25-5-111	25-5-110
25-5-112(1)	25-5-108(b) and (c)
25-5-112(2)	25-5-108(h)
25-5-112(3)	25-5-102(a)(12)
25-5-113	Omitted
25-5-114(1)	25-5-108(a)
25-5-114(2)	25-5-109(a)
25-5-114(3)	25-5-108(i)
25-5-115	25-5-111
25-5-116(1)	25-5-112
25-5-116(2)	25-5-114
25-5-116(3)	25-5-114
25-5-117	Omitted

ARTICLE 6.

Bulk Transfers.

§§ 25-6-101 through 25-6-105: Repealed by Session Laws 2004-190, s. 1, effective January 1, 2005.

Editor's Note. — Session Laws 2004-190, s, 6, provides that rights and obligations arising under Article 6 of Chapter 25 of the General Statutes and former G.S. 25-9-111 before January 1, 2005, remain valid and may be enforced as though those statutes had not been repealed.

§ 25-6-106: Repealed by Session Laws 1967, c. 562, s. 1.

§§ 25-6-107 through 25-6-111: Repealed by Session Laws 2004-190, s. 1, effective January 1, 2005.

Editor's Note. — Session Laws 2004-190, s, 6, provides that rights and obligations arising under Article 6 of Chapter 25 of the General Statutes and former G.S. 25-9-111 before January 1, 2005, remain valid and may be enforced as though those statutes had not been repealed.

ARTICLE 7.

Documents of Title.

(Revised)

Editor's Note. — Official Comments in Article 7: Copyright 2003 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1.

GENERAL.

§ 25-7-101. Short title.

This Article may be cited as Uniform Commercial Code — Documents of Title. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-101.

Changes: Revised for style only.

This Article is a revision of the 1962 Official Text with Comments as amended since 1962. The 1962 Official Text was a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraced the provisions of the Uniform Sales Act relating to negotiation of documents of title.

This Article does not contain the substantive criminal provisions found in the Uniform Warehouse Receipts and Bills of Lading Acts. These criminal provisions are inappropriate to a Commercial Code, and for the most part duplicate portions of the ordinary criminal law relating to frauds. This revision deletes the former Section 7-105 that provided that courts could apply a rule from Parts 2 and 3 by analogy to a situation not explicitly covered in the provisions on warehouse receipts or bills of lading when it was appropriate. This is, of course, an unexceptional proposition and need not be stated explicitly in the statute. Thus former Section 7-105 has been deleted. Whether applying a rule by analogy to a situation is appropriate depends upon the facts of each case.

The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damages or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See Section 7-103.

Cross References. — As to application or nonapplication of this Article to self-service storage facilities, see G.S. 44A-40(7).

Editor's Note. — Session Laws 2006-112, s. 25, effective October 1, 2006, rewrote Article 7 of Chapter 25 of the General Statutes. Where appropriate, historical citations to sections of former Article 7 have been placed under corresponding sections of revised Article 7.

Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Session Laws 2006-112, s. 61, provides: "The Revisor of Statutes shall cause to be printed along with this act all relevant portions of the official comments to Uniform Commercial Code Revised Article 1 and Uniform Commercial Code Revised Article 7 and all explanatory comments of the drafters of this act as the Revisor deems appropriate."

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

§ 25-7-102. Definitions and index of definitions.

(a) In this Article, unless the context otherwise requires:

(1) "Bailee" means a person that by a warehouse receipt, bill of lading, or other document of title acknowledges possession of goods and contracts to deliver them.

(2) "Carrier" means a person that issues a bill of lading.

(3) "Consignee" means a person named in a bill of lading to whom or to whose order the bill promises delivery.

(4) "Consignor" means a person named in a bill of lading as the person from whom the goods have been received for shipment.

(5) "Delivery order" means a record that contains an order to deliver goods directed to a warehouse, carrier, or other person that in the ordinary course of business issues warehouse receipts or bills of lading.

(6) Reserved for future codification purposes.

(7) "Goods" means all things that are treated as movable for the purposes of a contract for storage or transportation.

(8) "Issuer" means a bailee that issues a document of title or, in the case of an unaccepted delivery order, the person that orders the possessor of goods to deliver. The term includes a person for whom an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, even if the issuer did not receive any goods, the goods were misdescribed, or

in any other respect the agent or employee violated the issuer's instructions.

(9) "Person entitled under the document" means the holder, in the case of a negotiable document of title, or the person to whom delivery of the goods is to be made by the terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

(10) Reserved for future codification purposes.

(11) "Sign" means, with present intent to authenticate or adopt a record:
  a. To execute or adopt a tangible symbol; or
  b. To attach to or logically associate with the record an electronic sound, symbol, or process.

(12) "Shipper" means a person that enters into a contract of transportation with a carrier.

(13) "Warehouse" means a person engaged in the business of storing goods for hire.

(b) Definitions in other Articles applying to this Article and the sections in which they appear are:

(1) "Contract for sale," G.S. 25-2-106.
(2) "Lessee in the ordinary course of business," G.S. 25-2A-103.
(3) "Receipt" of goods, G.S. 25-2-103.

(c) In addition, Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article. (1917, c. 37, s. 58; 1919, c. 65, s. 42; C.S., ss. 280, 4037; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-102.

Changes: New definitions of "carrier," "good faith," "record," "sign," and "shipper." Other definitions revised to accommodate electronic mediums.

Purposes: 1. "Bailee" is used in this Article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when it does not have possession, the bailee is bound by sections of this Article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and Sections 7-203 and 7-301 on liability in case of non-receipt.) A "carrier" is one type of bailee and is defined as a person that issues a bill of lading. A "shipper" is a person who enters into the contract of transportation with the carrier. The definitions of "bailee," "consignee," "consignor," "goods", and "issuer", are unchanged in substance from prior law. "Document of title" is defined in Article 1, and may be in either tangible or electronic form.

2. The definition of warehouse receipt contained in the general definitions section of this Act (Section 1-201) does not require that the issuing warehouse be "lawfully engaged" in business or for profit. The warehouse's compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this Article. Certainly the issuer's violations of law should not diminish its responsibility on documents the issuer has put in commercial circulation. But it is still essential that the business be storing goods "for hire" (Section 1-201 and this section). A person does not become a warehouse by storing its own goods.

3. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods. Delivery orders may be either electronic or tangible documents of title. See definition of "document of title" in Section 1-201.

4. The obligation of good faith imposed by this Article and by Article 1, Section 1-304 includes the observance of reasonable commercial standards of fair dealing.

5. The definitions of "record" and "sign" are included to facilitate electronic mediums. See comment 9 to Section 9-102 discussing "record" and the comment to amended Section 2-103 discussing "sign."

6. "Person entitled under the document" is moved from former Section 7-403.

Cross References: Point 1: Sections 1-201, 7-203 and 7-301.
Point 2: Sections 1-201 and 7-203.
Point 3: Section 1-201.
Point 4: Section 1-304.
Point 5: Section 9-102 and 2-103.
See general comment to document of title in Section 1-201.

Definitional Cross References: "Bill of lading". Section 1-201.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Receipt of goods". Section 2-103.
"Right". Section 1-201.
"Warehouse receipt". Section 1-201.

Cross References. — As to public warehouses in general, see G.S. 66-35 to 66-40.

CASE NOTES

What Constitutes Warehouseman. — It mattered not if a concern was a person or partnership. If the concern was engaged in the business and goods were stored for profit, the former Uniform Warehouse Receipts Act applied. It mattered not if the concern stored its own and also the goods of others. Webb & Co. v. Friedberg, 189 N.C. 166, 126 S.E. 508 (1925), decided under former statutory provisions.

Warehouseman Bears Risk That Agent May Issue Improper Receipts. — Section 25-7-203, coupled with the definition of issuer under (1)(g) of this section, clearly places upon the warehouseman the risk that his agent may fraudulently or mistakenly issue improper receipts. The theory of the law is that the warehouseman, being in the best position to prevent the issuance of mistaken or fraudulent receipts, should be obligated to do so; that such receipts are a risk and cost of the business enterprise which the issuer is best able to absorb. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Cited in Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979); In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996); GATX Logistics, Inc. v. Lowe's Cos., 143 N.C. App. 695, 548 S.E.2d 193, 2001 N.C. App. LEXIS 338 (2001).

§ 25-7-103. Relation of Article to treaty or statute.

(a) This Article is subject to any treaty or statute of the United States or regulatory statute of this State to the extent the treaty, statute, or regulatory statute is applicable.

(b) This Article does not modify or repeal any law prescribing the form or content of a document of title or the services or facilities to be afforded by a bailee or otherwise regulating a bailee's business in respects not specifically treated in this Article. However, violation of such a law does not affect the status of a document of title that otherwise is within the definition of a document of title.

(c) This Article modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. § 7001, et seq.) but does not modify, limit, or supersede section 101(c) of that Act (15 U.S.C. § 7001(c)) or authorize electronic delivery of any of the notices described in section 103(b) of that Act (15 U.S.C. § 7003(b)).

(d) To the extent there is a conflict between Article 40 of Chapter 66 of the General Statutes (the Uniform Electronic Transactions Act) and this Article, this Article governs. (1965, c. 700, s. 1; 1997-181, s. 21; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Sections 7-103 and 10-104.

Changes: Deletion of references to tariffs and classifications; incorporation of former Section

10-104 into subsection (b), provide for intersection with federal and state law governing electronic transactions.

Purposes: 1. To make clear what would of course be true without the Section, that applicable Federal law is paramount.

2. To make clear also that regulatory state statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values, and limiting liability for loss to the declared value on which the charge was based) are not affected by the Article and are controlling on the matters which they cover unless preempted by federal law. The reference in former Section 7-103 to tariffs, classifications, and regulations filed or issued pursuant to regulatory state statutes has been deleted as inappropriate in the modern era of diminished regulation of carriers and warehouses. If a regulatory scheme requires a carrier or warehouse to issue a tariff or classification, that tariff or classification would be given effect via the state regulatory scheme that this Article recognizes as controlling. Permissive tariffs or classifications would not displace the provisions of this act, pursuant to this section, but may be given effect through the ability of parties to incorporate those terms by reference into their agreement.

3. The document of title provisions of this act supplement the federal law and regulatory state law governing bailees. This Article focuses on the commercial importance and usage of documents of title. State ex. rel Public Service Commission v. Gunkelman & Sons, Inc., 219 N.W.2d 853 (N.D. 1974).

4. Subsection (c) is included to make clear the interrelationship between the federal Electronic Signatures in Global and National Commerce Act and this article and the conforming amendments to other articles of the Uniform Commercial Code promulgated as part of the revision of this article. Section 102 of the federal act allows a State statute to modify, limit, or supersede the provisions of Section 101 of the federal act. See the comments to Revised Article 1, Section 1-108.

5. Subsection (d) makes clear that once this article is in effect, its provisions regarding electronic commerce and regarding electronic documents of title control in the event there is a conflict with the provisions of the Uniform Electronic Transactions Act or other applicable state law governing electronic transactions.

Cross References: Sections 1-108, 7-201, 7-202, 7-204, 7-206, 7-309, 7-401, 7-403.

Definitional Cross Reference: "Bill of lading". Section 1-201.

§ 25-7-104. Negotiable and nonnegotiable document of title.

(a) Except as otherwise provided in subsection (c) of this section, a document of title is negotiable if by its terms the goods are to be delivered to bearer or to the order of a named person.

(b) A document of title other than one described in subsection (a) of this section is nonnegotiable. A bill of lading that states that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against an order in a record signed by the same or another named person.

(c) A document of title is nonnegotiable if, at the time it is issued, the document has a conspicuous legend, however expressed, that it is nonnegotiable. (Rev., s. 3032; 1917, c. 37, ss. 4, 7; 1919, c. 65, ss. 3, 6, 7; C.S., ss. 285, 288, 289, 4044, 4045; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-104.

Changes: Subsection (a) is revised to reflect modern style and trade practice. Subsection (b) is revised for style and medium neutrality. Subsection (c) is new.

Purposes: 1. This Article deals with a class of commercial paper representing commodities in storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the Article of this Act on Commercial Paper (Article 3) and "investment paper" dealt with in the Article of this Act on Investment Securities (Article 8). The class of "commodity paper" is designated "document of title" following the terminology of the Uniform Sales Act Section 76. Section 1-201. The distinctions between negotiable and nonnegotiable documents in this section makes the most important subclassification employed in the Article, in that the holder of negotiable documents may acquire more rights than its transferor had (See Section 7-502). The former Section 7-104, which provided that a document of title was negotiable if it runs to a named person or assigns if such designation was recognized in overseas trade, has been deleted as not necessary in light of current commercial practice.

A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular kind of receipt in connection with delivery of the goods. Subsection (a) makes it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person. Either tangible or electronic documents of title may be negotiable if the document meets the requirement of this section.

2. Subsection (c) is derived from Section 3-104(d). Prior to issuance of the document of title, an issuer may stamp or otherwise provide by a notation on the document that it is nonnegotiable even if the document would otherwise comply with the requirement of subsection (a). Once issued as a negotiable document of title, the document cannot be changed from a negotiable document to a nonnegotiable document. A document of title that is nonnegotiable cannot be made negotiable by stamping or providing a notation that the document is negotiable. The only way to make a document of title negotiable is to comply with subsection (a). A negotiable document of title may fail to be duly negotiated if the negotiation does not comply with the requirements for "due negotiation" stated in Section 7-501.

Cross Reference: Sections 7-501 and 7-502.

Definitional Cross References: "Bearer". Section 1-201.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Person". Section 1-201.
"Sign". Section 7-102.
"Warehouse receipt". Section 1-201.

CASE NOTES

Applied in Branch Banking & Trust Co. v. Gill, 286 N.C. 342, 211 S.E.2d 327 (1975); Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

§ 25-7-105. Reissuance in alternative medium.

(a) Upon request of a person entitled under an electronic document of title, the issuer of the electronic document may issue a tangible document of title as a substitute for the electronic document if:

(1) The person entitled under the electronic document surrenders control of the document to the issuer; and

(2) The tangible document when issued contains a statement that it is issued in substitution for the electronic document.

(b) Upon issuance of a tangible document of title in substitution for an electronic document of title in accordance with subsection (a) of this section:

(1) The electronic document ceases to have any effect or validity; and

(2) The person that procured issuance of the tangible document warrants to all subsequent persons entitled under the tangible document that the warrantor was a person entitled under the electronic document when the warrantor surrendered control of the electronic document to the issuer.

(c) Upon request of a person entitled under a tangible document of title, the issuer of the tangible document may issue an electronic document of title as a substitute for the tangible document if:

(1) The person entitled under the tangible document surrenders possession of the document to the issuer; and

(2) The electronic document when issued contains a statement that it is issued in substitution for the tangible document.

(d) Upon issuance of an electronic document of title in substitution for a tangible document of title in accordance with subsection (c) of this section:

(1) The tangible document ceases to have any effect or validity; and
(2) The person that procured issuance of the electronic document warrants to all subsequent persons entitled under the electronic document that the warrantor was a person entitled under the tangible document when the warrantor surrendered possession of the tangible document to the issuer. (2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: None.

Other relevant law: UNCITRAL Draft Instrument on the Carriage of Goods by SeaTransport Law.

Purpose: 1. This section allows for documents of title issued in one medium to be reissued in another medium. This section applies to both negotiable and nonnegotiable documents. This section sets forth minimum requirements for giving the reissued document effect and validity. The issuer is not required to issue a document in an alternative medium and if the issuer chooses to do so, it may impose additional requirements. Because a document of title imposes obligations on the issuer of the document, it is imperative for the issuer to be the one who issues the substitute document in order for the substitute document to be effective and valid.

2. The request must be made to the issuer by the person entitled to enforce the document of title (Section 7-102(a)(9)) and that person must surrender possession or control of the original document to the issuer. The reissued document must have a notation that it has been issued as a substitute for the original document. These minimum requirements must be met in order to give the substitute document effect and validity. If these minimum requirements are not met for issuance of a substitute document of title, the original document of title continues to be effective and valid. Section 7-402. However, if the minimum requirements imposed by this section are met, in addition to any other requirements that the issuer may impose, the substitute document will be the document that is effective and valid.

3. To protect parties who subsequently take the substitute document of title, the person who procured issuance of the substitute document warrants that it was a person entitled under the original document at the time it surrendered possession or control of the original document to the issuer. This warranty is modeled after the warranty found in Section 4-209.

Cross Reference: Sections 7-106, 7-402 and 7-601.

Definitional Cross Reference: "Person entitled to enforce," Section 7-102.

§ 25-7-106. Control of electronic document of title.

(a) A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

(b) A system satisfies subsection (a) of this section, and a person is deemed to have control of an electronic document of title, if the document is created, stored, and assigned in such a manner that:
(1) A single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in subdivisions (4), (5), and (6) of this subsection, unalterable;
(2) The authoritative copy identifies the person asserting control as:
  a. The person to whom the document was issued; or
  b. If the authoritative copy indicates that the document has been transferred, the person to whom the document was most recently transferred;
(3) The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;
(4) Copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and
(6) Any amendment of the authoritative copy is readily identifiable as authorized or unauthorized. (2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Uniform Electronic Transactions Act Section 16.

Purpose: 1. The section defines "control" for electronic documents of title and derives its rules from the Uniform Electronic Transactions Act § 16 on transferrable records. Unlike UETA § 16, however, a document of title may be reissued in an alternative medium pursuant to Section 7-105. At any point in time in which a document of title is in electronic form, the control concept of this section is relevant. As under UETA § 16, the control concept embodied in this section provides the legal framework for developing systems for electronic documents of title.

2. Control of an electronic document of title substitutes for the concept of indorsement and possession in the tangible document of title context. See Section 7-501. A person with a tangible document of title delivers the document by voluntarily transferring possession and a person with an electronic document of title delivers the document by voluntarily transferring control. (Delivery is defined in Section 1-201).

3. Subsection (a) sets forth the general rule that the "system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred." The key to having a system that satisfies this test is that identity of the person to which the document was issued or transferred must be reliably established. Of great importance to the functioning of the control concept is to be able to demonstrate, at any point in time, the person entitled under the electronic document. For example, a carrier may issue an electronic bill of lading by having the required information in a database that is encrypted and accessible by virtue of a password. If the computer system in which the required information is maintained identifies the person as the person to which the electronic bill of lading was issued or transferred, that person has control of the electronic document of title. That identification may be by virtue of passwords or other encryption methods. Registry systems may satisfy this test. For example, see the electronic warehouse receipt system established pursuant to 7 C.F.R. Part 735. This Article leaves to the market place the development of sufficient technologies and business practices that will meet the test.

An electronic document of title is evidenced by a record consisting of information stored in an electronic medium. Section 1-201. For example, a record in a computer database could be an electronic document of title assuming that it otherwise meets the definition of document of title. To the extent that third parties wish to deal in paper mediums, Section 7-105 provides a mechanism for exiting the electronic environment by having the issuer reissue the document of title in a tangible medium. Thus if a person entitled to enforce an electronic document of title causes the information in the record to be printed onto paper without the issuer's involvement in issuing the document of title pursuant to Section 7-105, that paper is not a document of title.

4. Subsection (a) sets forth the general test for control. Subsection (b) sets forth a safe harbor test that if satisfied, results in control under the general test in subsection (a). The test in subsection (b) is also used in Section 9-105 although Section 9-105 does not include the general test of subsection (a). Under subsection (b), at any point in time, a party should be able to identify the single authoritative copy which is unique and identifiable as the authoritative copy. This does not mean that once created that the authoritative copy need be static and never moved or copied from its original location. To the extent that backup systems exist which result in multiple copies, the key to this idea is that at any point in time, the one authoritative copy needs to be unique and identifiable.

Parties may not by contract provide that control exists. The test for control is a factual test that depends upon whether the general test in subsection (a) or the safe harbor in subsection (b) is satisfied.

5. Article 7 has historically provided for rights under documents of title and rights of transferees of documents of title as those rights relate to the goods covered by the document. Third parties may possess or have control of documents of title. While misfeasance or negligence in failure to transfer or misdelivery of the document by those third parties may create serious issues, this Article has never dealt with those issues as it relates to tangible documents of title, preferring to leave those issues to the law of contracts, agency and tort law. In the electronic document of title regime, third party registry systems are just beginning to develop.

It is very difficult to write rules regulating those third parties without some definitive sense of how the third party registry systems will be structured. Systems that are evolving to date tend to be "closed" systems in which all participants must sign on to the master agreement which provides for rights as against the registry system as well as rights among the members. In those closed systems, the document of title never leaves the system so the parties rely upon the master agreement as to rights against the registry for its failures in dealing with the document. This article contemplates that those "closed" systems will continue to evolve and that the control mechanism in this statute provides a method for the participants in the closed system to achieve the benefits of obtaining control allowed by this article.

This article also contemplates that parties will evolve open systems where parties need not be subject to a master agreement. In an open system a party that is expecting to obtain rights through an electronic document may not be a party to the master agreement. To the extent that open systems evolve by use of the control concept contained in this section, the law of contracts, agency, and torts as it applies to the registry's misfeasance or negligence concerning the transfer of control of the electronic document will allocate the risks and liabilities of the parties as that other law now does so for third parties who hold tangible documents and fail to deliver the documents.

Cross Reference: Sections 7-105 and 7-501.

Definitional Cross-References: "Delivery", 1-201.

"Document of title", 1-201.

PART 2.

WAREHOUSE RECEIPTS: SPECIAL PROVISIONS.

§ 25-7-201. Person that may issue a warehouse receipt; storage under bond.

(a) A warehouse receipt may be issued by any warehouse.

(b) If goods, including distilled spirits and agricultural commodities, are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods is deemed to be a warehouse receipt even if issued by a person that is the owner of the goods and is not a warehouse. (1917, c. 37, s. 1; C.S., s. 4041; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-201.

Changes: Update for style only.

Purposes: It is not intended by re-enactment of subsection (a) to repeal any provisions of special licensing or other statutes regulating who may become a warehouse. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. Section 7-103. Compare Section 7-401(4) on the liability of the issuer in such cases. Subsection (b) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 51.

Cross References: Sections 7-103, 7-401.

Definitional Cross References: "Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 25-7-202. Form of warehouse receipt; effect of omission.

(a) A warehouse receipt need not be in any particular form.

(b) Unless a warehouse receipt provides for each of the following, the warehouse is liable for damages caused to a person injured by its omission:

(1) A statement of the location of the warehouse facility where the goods are stored;

(2) The date of issue of the receipt;

(3) The unique identification code of the receipt;
(4) A statement whether the goods received will be delivered to the bearer, to a named person, or to a named person or its order;
(5) The rate of storage and handling charges, unless goods are stored under a field warehousing arrangement, in which case a statement of that fact is sufficient on a nonnegotiable receipt;
(6) A description of the goods or the packages containing them;
(7) The signature of the warehouse or its agent;
(8) If the receipt is issued for goods that the warehouse owns, either solely, jointly, or in common with others, a statement of the fact of that ownership; and
(9) A statement of the amount of advances made and of liabilities incurred for which the warehouse claims a lien or security interest, unless the precise amount of advances made or liabilities incurred, at the time of the issue of the receipt, is unknown to the warehouse or to its agent that issued the receipt, in which case a statement of the fact that advances have been made or liabilities incurred and the purpose of the advances or liabilities is sufficient.

(c) A warehouse may insert in its receipt any terms that are not contrary to this Chapter and do not impair its obligation of delivery under G.S. 25-7-403 or its duty of care under G.S. 25-7-204. Any contrary provision is ineffective. (Rev., s. 3032; 1917, c. 37, ss. 2, 3; C.S., ss. 4042, 4043; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-202.

Changes: Language is updated to accommodate electronic commerce and to reflect modern style.

Purposes: 1. This section does not displace any particular legislation that requires other terms in a warehouse receipt or that may require a particular form of a warehouse receipt. This section does not require that a warehouse receipt be issued. A warehouse receipt that is issued need not contain any of the terms listed in subsection (b) in order to qualify as a warehouse receipt as long as the receipt falls within the definition of "warehouse receipt" in Article 1. Thus the title has been changed to eliminate the phrase "essential terms" as provided in prior law. The only consequence of a warehouse receipt not containing any term listed in subsection (b) is that a person injured by a term's omission has a right as against the warehouse for harm caused by the omission. Cases, such as In re Celotex Corp., 134 B. R. 993 (Bankr. M.D. Fla. 1991), that held that in order to have a valid warehouse receipt all of the terms listed in this section must be contained in the receipt, are disapproved.

2. The unique identification code referred to in subsection (b)(3) can include any combination of letters, number, signs, and/or symbols that provide a unique identification. Whether an electronic or tangible warehouse receipt contains a signature will be resolved with the definition of sign in Section 7-102.

Cross References: Sections 7-103 and 7-401.

Definitional Cross References: "Bearer". Section 1-201.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Security interest". Section 1-201.
"Sign". Section 7-102.
"Term". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

CASE NOTES

Valid Receipt Does Not Require All Listed Terms. — This section does not require that all of the listed terms in this section be included for a warehouse receipt to be valid. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

"Household Goods Descriptive Inventory" was sufficient to constitute a warehouse receipt for purposes of holding defendant moving company responsible under Art. 7 for its actions as a warehouseman where the document listed each item picked up, its condition, the owner's name, the original loading address, and was signed and dated by defendant's authorized agent and driver. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

Because an inventory of goods is valid as a warehouse receipt as against defendant, principles of fairness dictate that it should also be valid as a warehouse receipt against plaintiffs who have benefited from the storage of their goods. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Invoice Held Not Receipt. — Where invoice from warehouseman itemized warehouse charges and stated the amount due, invoice did not qualify as a "warehouse receipt" as required for Uniform Commercial Code warehouseman's lien. In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

§ 25-7-203. Liability for nonreceipt or misdescription.

A party to or purchaser for value in good faith of a document of title, other than a bill of lading, that relies upon the description of the goods in the document may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to the extent that:

(1) The document conspicuously indicates that the issuer does not know whether all or part of the goods in fact were received or conform to the description, such as a case in which the description is in terms of marks or labels or kind, quantity, or condition, or the receipt or description is qualified by "contents, condition, and quality unknown," "said to contain," or words of similar import, if the indication is true; or

(2) The party or purchaser otherwise has notice of the nonreceipt or misdescription. (1917, c. 37, s. 20; C.S., s. 4060; 1931, c. 358, s. 1; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-203.

Changes: Changes to this section are for style only.

Purpose: This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of its principal, without receiving goods. No disclaimer of the latter liability is permitted.

Cross Reference: Section 7-301.

Definitional Cross References: "Conspicuous". Section 1-201.

"Document of title". Section 1-201.
"Goods". Section 7-102.
"Good Faith". Section 1-201. [7-102]
"Issuer". Section 7-102.
"Notice". Section 1-202.
"Party". Section 1-201.
"Purchaser". Section 1-201.
"Receipt of goods". Section 2-103.
"Value". Section 1-204.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

CASE NOTES

The purpose of this section is to protect specified parties to or purchasers of warehouse receipts by imposing liability upon the warehouseman when either he or his agent fraudulently or mistakenly issues receipts (negotiable or nonnegotiable) for misdescribed or nonexistent goods. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Applicability of Section. — This section covers the situation where the sole question is: Under what circumstances and to whom is an issuer liable for the issuance of warehouse receipts when it has not received the goods which the receipts purportedly cover? Branch

Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Parties May Not Keep Themselves in Ignorance of Facts. — Albeit "good faith" is literally defined as "honesty in fact in the conduct or transaction concerned," the Uniform Commercial Code does not permit parties to intentionally keep themselves in ignorance of facts which, if known, would defeat their rights in a negotiable document of title. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

No Requirement to Take Documents Through "Due Negotiation". — This section contains no requirement that the purchaser take negotiable documents through "due negotiation" before he can recover from the issuer. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Warehouseman Bears Risk That Agent May Issue Improper Receipts. — This section coupled with the definition of issuer under G.S. 25-7-102(1)(g), clearly places upon the warehouseman the risk that his agent may fraudulently or mistakenly issue improper receipts. The theory of the law is that the warehouseman, being in the best position to prevent the issuance of mistaken or fraudulent receipts, should be obligated to do so; that such receipts are a risk and cost of the business enterprise which the issuer is best able to absorb. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Claimant's Burden of Proof. — To be entitled to recover under this section, claimant has the burden of proving that he: (1) is a party to or purchaser of a document of title other than a bill of lading; (2) gave value for the document; (3) took the document in good faith; (4) relied to his detriment upon the description of the goods in the document; and (5) took without notice that the goods were misdescribed or were never received by the issuer. Many of these terms are defined in G.S. 25-1-201 and those definitions are also made applicable to Article 7, G.S. 25-7-102(4). Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

§ 25-7-204. Duty of care; contractual limitation of warehouse's liability.

(a) A warehouse is liable for damages for loss of or injury to the goods caused by its failure to exercise care with regard to the goods that a reasonably careful person would exercise under similar circumstances. Unless otherwise agreed, the warehouse is not liable for damages that could not have been avoided by the exercise of that care.

(b) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage beyond which the warehouse is not liable. Such a limitation is not effective with respect to the warehouse's liability for conversion to its own use. On request of the bailor in a record at the time of signing the storage agreement or within a reasonable time after receipt of the warehouse receipt, the warehouse's liability may be increased on part or all of the goods covered by the storage agreement or the warehouse receipt. In this event, increased rates may be charged based on an increased valuation of the goods.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the bailment may be included in the warehouse receipt or storage agreement.

(d) This section does not modify or repeal any statute that imposes a higher responsibility upon the warehouse or invalidates a contractual limitation that would be permissible under this Article. (1917, c. 37, s. 21; C.S., s. 4061; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-204.

Changes: Updated to reflect modern, standard commercial practices.

Purposes of Changes: 1. Subsection (a) continues the rule without change from former Section 7-204 on the warehouse's obligation to exercise reasonable care.

2. Former Section 7-204(2) required that the term limiting damages do so by setting forth a specific liability per article or item or of a value per unit of weight. This requirement has been deleted as out of step with modern industry

practice. Under subsection (b) a warehouse may limit its liability for damages for loss of or damage to the goods by a term in the warehouse receipt or storage agreement without the term constituting an impermissible disclaimer of the obligation of reasonable care. The parties cannot disclaim by contract the warehouse's obligation of care. Section 1-302. For example, limitations based upon per unit of weight, per package, per occurrence, or per receipt as well as limitations based upon a multiple of the storage rate may be commercially appropriate. As subsection (d) makes clear, the states or the federal government may supplement this section with more rigid standards of responsibility for some or all bailees.

3. Former Section 7-204(2) also provided that an increased rate can not be charged if contrary to a tariff. That language has been deleted. If a tariff is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section allowing an increased rate. The provisions of a non-mandatory tariff may be incorporated by reference in the parties' agreement. See Comment 2 to Section 7-103. Subsection (c) deletes the reference to tariffs for the same reason that the reference has been omitted in subsection (b).

4. As under former Section 7-204(2), subsection (b) provides that a limitation of damages is ineffective if the warehouse has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the warehouse's own use. See Adams v. Ryan & Christie Storage, Inc., 563 F. Supp. 409 (E.D. Pa. 1983) aff'd 725 F.2d 666 (3rd Cir. 1983). Cases such as I.C.C. Metals Inc. v. Municipal Warehouse Co., 409 N.E. 2d 849 (N.Y. Ct. App. 1980) holding that mere failure to redeliver results in a presumption of conversion to the warehouse's own use are disapproved. "Conversion to its own use" is narrower than the idea of conversion generally. Cases such as Lipman v. Peterson, 575 P.2d 19 (Kan. 1978) holding to the contrary are disapproved.

5. Storage agreements commonly establish the contractual relationship between warehouses and depositors who have an on-going relationship. The storage agreement may allow for the movement of goods into and out of a warehouse without the necessity of issuing or amending a warehouse receipt upon each entry or exit of goods from the warehouse.

Cross References: Sections 1-302, 7-103, 7-309 and 7-403.

Definitional Cross References: "Goods". Section 7-102.
"Reasonable time". Section 1-204.
"Sign". Section 7-102.
"Term". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

NORTH CAROLINA COMMENT

The General Statutes Commission modified subsection (d) to bring forward former G.S. 25-7-204(4).

CASE NOTES

Irregularity in Warehouse Receipt. — Even though "Household Goods Descriptive Inventory" was probably irregular as a warehouse receipt, this irregularity did not relieve defendant of his duty to act as a reasonably careful person in relation to plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

§ 25-7-205. Title under warehouse receipt defeated in certain cases.

A buyer in ordinary course of business of fungible goods sold and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-205.

Changes: Changes for style only.

Purposes: 1. The typical case covered by this section is that of the warehouse-dealer in grain, and the substantive question at issue is whether in case the warehouse becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouse. Moreover, on default of the warehouse, the receipt holders at least share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces the purchaser completely to the status of general creditor in a situation where there was very little the purchaser could do to guard against the loss. Compare 15 U.S.C. Section 714p enacted in 1955.

2. This provision applies to both negotiable and nonnegotiable warehouse receipts. The concept of due negotiation is provided for in 7-501. The definition of "buyer in ordinary course" is in Article 1 and provides, among other things, that a buyer must either have possession or a right to obtain the goods under Article 2 in order to be a buyer in ordinary course. This section requires actual delivery of the fungible goods to the buyer in ordinary course. Delivery requires voluntary transfer of possession of the fungible goods to the buyer. See amended Section 2-103. This section is not satisfied by the delivery of the document of title to the buyer in ordinary course.

Cross References: Sections 2-403 and 9-320.

Definitional Cross References: "Buyer in ordinary course of business". Section 1-201.
"Delivery". Section 1-201.
"Duly negotiate". Section 7-501.
"Fungible" goods. Section 1-201.
"Goods". Section 7-102.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

§ 25-7-206. Termination of storage at warehouse's option.

(a) A warehouse, by giving notice to the person on whose account the goods are held and any other person known to claim an interest in the goods, may require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document of title or, if a period is not fixed, within a stated period not less than 30 days after the warehouse gives notice. If the goods are not removed before the date specified in the notice, the warehouse may sell them pursuant to G.S. 25-7-210.

(b) If a warehouse in good faith believes that goods are about to deteriorate or decline in value to less than the amount of its lien within the time provided in subsection (a) of this section and G.S. 25-7-210, the warehouse may specify in the notice given under subsection (a) of this section any reasonable shorter time for removal of the goods and, if the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(c) If, as a result of a quality or condition of the goods of which the warehouse did not have notice at the time of deposit, the goods are a hazard to other property, the warehouse facilities, or other persons, the warehouse may sell the goods at public or private sale without advertisement or posting on reasonable notification to all persons known to claim an interest in the goods. If the warehouse, after a reasonable effort, is unable to sell the goods, it may dispose of them in any lawful manner and does not incur liability by reason of that disposition.

(d) A warehouse shall deliver the goods to any person entitled to them under this Article upon due demand made at any time before sale or other disposition under this section.

(e) A warehouse may satisfy its lien from the proceeds of any sale or disposition under this section but shall hold the balance for delivery on the demand of any person to whom the warehouse would have been bound to deliver the goods. (Rev., ss. 3036 to 3040; 1917, c. 37, ss. 33, 34; C.S., ss. 4073, 4074; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-206.

Changes: Changes for style.

Purposes: 1. This section provides for three situations in which the warehouse may terminate storage for reasons other then enforcement of its lien as permitted by Section 7-210. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouse's power to terminate the bailment, since it would be commercially intolerable to allow warehouses to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under subsection (a) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods the pre-Code Uniform Warehouse Receipts Act, Section 34, made no distinction between cases where the warehouse knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (b) and (c) distinguish between the two situations. The reason of this section should apply if the goods become hazardous during the course of storage. The process for selling the goods described in Section 7-210 governs the sale of goods under this section except as provided in subsections (b) and (c) for the situations described in those subsections respectively.

3. Protection of its lien is the only interest which the warehouse has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threatens the warehouse's security.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehouses from discriminating among customers. Nor does the section relieve the warehouse of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such regulatory statutes and the regulations under them remain in force and operative. Section 7-103.

Cross References: Sections 7-103 and 7-403.

Definitional Cross References: "Delivery". Section 1-201.
"Document of title". Section 1-102.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Notice". Section 1-202.
"Notification". Section 1-202.
"Person". Section 1-201.
"Reasonable time". Section 1-205.
"Value". Section 1-204.
"Warehouse". Section 7-102.

§ 25-7-207. Goods must be kept separate; fungible goods.

(a) Unless the warehouse receipt provides otherwise, a warehouse shall keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods. However, different lots of fungible goods may be commingled.

(b) If different lots of fungible goods are commingled, the goods are owned in common by the persons entitled thereto and the warehouse is severally liable to each owner for that owner's share. If, because of overissue, a mass of fungible goods is insufficient to meet all the receipts the warehouse has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated. (Rev., s. 3034; 1917, c. 37, ss. 22 to 24; C.S., ss. 4062 to 4064; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-207.

Changes: Changes for style only.

Purposes: No change of substance is made from former Section 7-207. Holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

Definitional Cross References: "Delivery". Section 1-201.
"Duly negotiate". Section 7-501.
"Fungible goods". Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Person". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

§ 25-7-208. Altered warehouse receipts.

If a blank in a negotiable tangible warehouse receipt has been filled in without authority, a good-faith purchaser for value and without notice of the lack of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any tangible or electronic warehouse receipt enforceable against the issuer according to its original tenor. (1917, c. 37, s. 13; C.S., s. 4053; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-208.

Changes: To accommodate electronic documents of title.

Purpose: 1. The execution of tangible warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former. The purchaser must have purchased the tangible negotiable warehouse receipt in good faith and for value to be protected under the rule of the first sentence which is a limited exception to the general rule in the second sentence. Electronic document of title systems should have protection against unauthorized access and unauthorized changes. See 7-106. Thus the protection for good faith purchasers found in the first sentence is not necessary in the context of electronic documents.

2. Under the second sentence of this section, an unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of its liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouse. The rule stated in the second sentence applies to both tangible and electronic warehouse receipts.

Definitional Cross References: "Good faith". Section 1-201 [7-102].
"Issuer". Section 7-102.
"Notice". Section 1-202.
"Purchaser". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.

§ 25-7-209. Lien of warehouse.

(a) A warehouse has a lien against the bailor on the goods covered by a warehouse receipt or storage agreement or on the proceeds thereof in its possession for charges for storage or transportation, including demurrage and terminal charges, insurance, labor, or other charges, present or future, in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for similar charges or expenses in relation to other goods whenever deposited and it is stated in the warehouse receipt or storage agreement that a lien is claimed for charges and expenses in relation to other goods, the warehouse also has a lien against the goods covered by the warehouse receipt or storage agreement or on the proceeds thereof in its possession for those charges and expenses, whether or not the other goods have been delivered by the warehouse. However, as against a person to which a negotiable warehouse receipt is duly negotiated, a warehouse's lien is limited to charges in an amount or at a rate specified in the warehouse receipt or, if no charges are so specified, to a reasonable charge for storage of the specific goods covered by the receipt subsequent to the date of the receipt.

(b) A warehouse may also reserve a security interest against the bailor for the maximum amount specified on the receipt for charges other than those specified in subsection (a) of this section, such as for money advanced and interest. The security interest is governed by Article 9 of this Chapter.

(c) A warehouse's lien for charges and expenses under subsection (a) of this section or a security interest under subsection (b) of this section is also effective against any person that so entrusted the bailor with possession of the goods that a pledge of them by the bailor to a good-faith purchaser for value would have been valid. However, the lien or security interest is not effective against a person that before issuance of a document of title had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with:
   a. Actual or apparent authority to ship, store, or sell;
   b. Power to obtain delivery under G.S. 25-7-403; or
   c. Power of disposition under G.S. 25-2-403, 25-2A-304(2), 25-2A-305(2), 25-9-320, or 25-9-321(c) or other statute or rule of law; or
(2) Acquiesce in the procurement by the bailor or its nominee of any document.

(d) A warehouse's lien on household goods for charges and expenses in relation to the goods under subsection (a) of this section is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. In this subsection, "household goods" means furniture, furnishings, or personal effects used by the depositor in a dwelling.

(e) A warehouse loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver. (1917, c. 37, ss. 27 to 31, 41; 1919, c. 65, s. 31; C.S., ss. 313, 4067 to 4071, 4081; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 2000-169, s. 20; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Sections 7-209 and 7-503.

Changes: Expanded to recognize warehouse lien when a warehouse receipt is not issued but goods are covered by a storage agreement.

Purposes: 1. Subsection (a) defines the warehouse's statutory lien. Other than allowing a warehouse to claim a lien under this section when there is a storage agreement and not a warehouse receipt, this section remains unchanged in substance from former Section 7-209(1). Under the first sentence, a specific lien attaches automatically without express notation on the receipt or storage agreement with regard to goods stored under the receipt or the storage agreement. That lien is limited to the usual charges arising out of a storage transaction.

> Example 1: Bailor stored goods with a warehouse and the warehouse issued a warehouse receipt. A lien against those goods arose as set forth in subsection (a), the first sentence, for the charges for storage and the other expenses of those goods. The warehouse may enforce its lien under Section 7-210 as against the bailor. Whether the warehouse receipt is negotiable or nonnegotiable is not important to the warehouse's rights as against the bailor.

Under the second sentence, by notation on the receipt or storage agreement, the lien can be made a general lien extending to like charges in relation to other goods. Both the specific lien and general lien are as to goods in the possession of the warehouse and extend to proceeds from the goods as long as the proceeds are in the possession of the warehouse. The same rules apply whether the receipt is negotiable or non-negotiable.

> Example 2: Bailor stored goods (lot A) with a warehouse and the warehouse issued a warehouse receipt for those goods. In the warehouse receipt it is stated that the warehouse will also have a lien on goods covered by the warehouse receipt for storage charges and the other expenses for any other goods that are stored with the warehouse by the bailor. The statement about the lien on other goods does not specify an amount or a rate. Bailor then stored other goods (lot B) with the warehouse. Under subsection (a), first sentence, the warehouse has a lien on the specific goods (lot A) covered by the warehouse receipt. Under subsection (a), second sentence, the warehouse has a lien on the goods in lot A for the storage charges and the other expenses arising from the goods in lot B. That lien is enforceable as against the bailor regardless of whether the receipt is

negotiable or nonnegotiable.

Under the third sentence, if the warehouse receipt is negotiable, the lien as against a holder of that receipt by due negotiation is limited to the amount or rate specified on the receipt for the specific lien or the general lien, or, if none is specified, to a reasonable charge for storage of the specific goods covered by the receipt for storage after the date of the receipt.

Example 3: Same facts as Example 1 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the warehouse may enforce its lien against the bailor's goods stored in the warehouse as against the person to whom the negotiable warehouse receipt has been duly negotiated. Section 7-502. That lien is limited to the charges or rates specified in the receipt or a reasonable charge for storage as stated in the last sentence of subsection (a).

Example 4: Same facts as Example 2 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is not enforceable as against the person to whom the receipt has been duly negotiated. Without a statement of a specified amount or rate for the general lien, the warehouse's general lien is not enforceable as against the person to whom the negotiable document has been duly negotiated. However, the warehouse lien for charges and expenses related to storage of lot A goods is still enforceable as against the person to whom the receipt was duly negotiated.

Example 5. Same facts as Examples 2 and 4 except the warehouse had stated on the negotiable warehouse receipt a specified amount or rate for the general lien on other goods (lot B). Under the last sentence of subsection (a), the general lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is enforceable as against the person to whom the receipt has been duly negotiated.

2. Subsection (b) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financier or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare Sections 9-109 and 9-333. It is governed in all respects by Article 9, except that subsection (b) requires that the receipt specify a maximum amount and limits the security interest to the amount specified. A warehouse could also take a security interest to secure its charges for storage and the other expenses listed in subsection (a) to protect these claims upon the loss of the statutory possessory warehouse lien if the warehouse loses possession of the goods as provided in subsection (e).

Example 6: Bailor stores goods with a warehouse and the warehouse issues a warehouse receipt that states that the warehouse is taking a security interest in the bailed goods for charges of storage, expenses, for money advanced, for manufacturing services rendered, and all other obligations that the bailor may owe the warehouse. That is a security interest covered in all respects by Article 9. Subsection (b). As allowed by this section, a warehouse may rely upon its statutory possessory lien to protect its charges for storage and the other expenses related to storage. For those storage charges covered by the statutory possessory lien, the warehouse is not required to use a security interest under subsection (b).

3. Subsections (a) and (b) validate the lien and security interest "against the bailor." Under basic principles of derivative rights as provided in Section 7-504, the warehouse lien is also valid as against parties who obtain their rights from the bailor except as otherwise provided in subsection (a), third sentence, or subsection (c).

Example 7: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt that also claims a general lien in other goods stored with the warehouse. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor notifies the warehouse that the goods have been sold to Buyer and the bailee acknowledges that fact to the Buyer. Section 2-503. The warehouse lien for storage of those goods is effective against Buyer for both the specific lien and the general lien. Section 7-504.

Example 8: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the goods while the goods are in the warehouse's possession to Secured Party (SP) who properly perfects a security interest in the goods. See Revised 9-312(d). The warehouse lien is superior in priority over SP's security interest. See Revised 9-203(b)(2) (debtor can grant a security interest to the extent of debtor's rights in the collateral).

Example 9: Bailor stores goods with a warehouse and the warehouse issues a negotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the negotiable document to SP. SP properly perfects its interest in the negotiable document by taking possession through a "due negotiation." Revised 9-312(c). SP's security interest is subordinate to the warehouse lien. Section 7-209(a), third sentence. Given that bailor's rights are subject to the warehouse lien, the bailor cannot grant to the SP greater rights than the bailor has under Section 9-203(b)(2), perfection of the security interest in the negotiable document and the goods covered by the document through SP's filing of a financing statement should not give a different result.

As against third parties who have interests in the goods prior to the storage with the warehouse, subsection (c) continues the rule under the prior uniform statutory provision that to validate the lien or security interest of the warehouse, the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of its goods by a thief. The warehouse may be protected because of the actual, implied or apparent authority of the depositor, because of a Factor's Act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under the second sentence of subsection (c). The language of Section 7-503 is brought into subsection (c) for purposes of clarity. The comments to Section 7-503 are helpful in interpreting delivery, entrustment or acquiescence.

Where the third party is the holder of a security interest, obtained prior to the issuance of a negotiable warehouse receipt, the rights of the warehouse depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly Section 9-322. Thus the special priority granted to statutory liens by Section 9-333 does not apply to liens under subsection (a) of this section, since subsection (c), second sentence, "expressly provides otherwise" within the meaning of Section 9-333.

As to household goods, however, subsection (d) makes the warehouse's lien "for charges and expenses in relation to the goods" effective against all persons if the depositor was the legal possessor. The purpose of the exception is to permit the warehouse to accept household goods for storage in sole reliance on the value of the goods themselves, especially in situations of family emergency.

Example 10: Bailor grants a perfected security interest in the goods to SP prior to storage of the goods with the warehouse. Bailor then stores goods with the warehouse and the warehouse issues a warehouse receipt for the goods. A warehouse lien on the bailed goods for the charges for storage or other expenses arises under subsection (a). The warehouse lien is not effective as against SP unless SP entrusted the goods to the bailor with actual or apparent authority to ship store, or sell the goods or with power of disposition under subsection (c)(1) or acquiesced in the bailor's procurement of a document of title under subsection (c)(2). This result obtains whether the receipt is negotiable or nonnegotiable.

Example 11: Sheriff who had lawfully repossessed household goods in an eviction action stored the goods with a warehouse. A lien on the bailed goods arises under subsection (a). The lien is effective as against the owner of the goods. Subsection (d).

4. As under previous law, this section creates a statutory possessory lien in favor of the warehouse on the goods stored with the warehouse or on the proceeds of the goods. The warehouse loses its lien if it loses possession of the goods or the proceeds. Subsection (e).

5. Where goods have been stored under a non-negotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in Section 2-503(4) on tender of delivery and include procurement of an acknowledgment by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of subsection (a), continues valid unless the bailee gives it up. See Section 7-403. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of subsection (a); unless the buyer undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under subsection (b).

6. A possessory warehouse lien arises as provided under subsection (a) if the parties to the bailment have a storage agreement or a warehouse receipt is issued. In the modern warehouse, the bailor and the bailee may enter into a master contract governing the bailment with the bailee and bailor keeping track of the goods stored pursuant to the master contract by notation on their respective books and records and the parties send notification via electronic

communication as to what goods are covered by the master contract. Warehouse receipts are not issued. See Comment 4 to Section 7-204. There is no particular form for a warehouse receipt and failure to contain any of the terms listed in Section 7-202 does not deprive the warehouse of its lien that arises under subsection (a). See the comment to Section 7-202.

Cross References: Point 1: Sections 7-501 and 7-502.

Point 2: Sections 9-109 and 9-333.

Point 3: Sections 2-503, 7-503, 7-504, 9-203, 9-312, and 9-322.

Point 4: Sections 2-503, 7-501, 7-502, 7-504, 9-312, 9-331, 9-333, 9-401.

Point 5: Sections 2-503 and 7-403.

Point 6: Sections 7-202 and 7-204.

Definitional Cross References: "Delivery". Section 1-201.

"Document of Title". Section 1-201.
"Goods". Section 7-102.
"Money". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Right". Section 1-201.
"Security interest". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

CASE NOTES

The proper issuance of a warehouse receipt requires not only mailing, but mailing to the proper address. Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979).

And Question of Proper Address Is for Trier of Fact. — Where the question of whether defendant mailed the receipt to the proper address is disputed by the parties, it must be determined by the trier of fact and since it is a material fact, summary judgment for either party would not be proper. Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979).

Sheriff Legally Possessed Personal Property Removed from Foreclosed Property. — Where purchaser contracted with moving company to remove personal property from foreclosed property, he did so at the request of the sheriff's deputies, and the sheriff was both the depositor of the goods and the legal possessor as defined in subsection (3)(b). Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Warehousemen Rights. — Any rights a warehouseman had were to be analyzed as a warehouseman's lien under chapter 25 rather than as a possessory lien under chapter 44A. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Cited in Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989); In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

§ 25-7-210. Enforcement of warehouse's lien.

(a) Except as otherwise provided in subsection (b) of this section, a warehouse's lien may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the warehouse is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The warehouse sells in a commercially reasonable manner if the warehouse sells the goods in the usual manner in any recognized market therefore, sells at the price current in that market at the time of the sale, or otherwise sells in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) A warehouse may enforce its lien on goods, other than goods stored by a merchant in the course of its business, only if the following requirements are satisfied:

(1) All persons known to claim an interest in the goods must be notified.

(2) The notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than 10 days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place.

(3) The sale must conform to the terms of the notification.

(4) The sale must be held at the nearest suitable place to where the goods are held or stored.

(5) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account the goods are being held, and the time and place of the sale. The sale must take place at least 15 days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least 10 days before the sale in not fewer than six conspicuous places in the neighborhood of the proposed sale.

(c) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the warehouse subject to the terms of the receipt and this Article.

(d) A warehouse may buy at any public sale held pursuant to this section.

(e) A purchaser in good faith of goods sold to enforce a warehouse's lien takes the goods free of any rights of persons against whom the lien was valid, despite the warehouse's noncompliance with this section.

(f) A warehouse may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to whom the warehouse would have been bound to deliver the goods.

(g) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(h) If a lien is on goods stored by a merchant in the course of its business, the lien may be enforced in accordance with subsection (a) or (b) of this section.

(i) A warehouse is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion. (Rev., ss. 3036 to 3038, 3041; 1917, c. 37, ss. 32, 33, 35; C.S., ss. 4072, 4073, 4075; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-210.

Changes: Update to accommodate electronic commerce and for style.

Purposes:

1. Subsection (a) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except non-commercial storage with a warehouse. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale are retained in subsection (b) with one change. The requirement in former Section 7-210(2)(b) that the notification must be sent in person or by registered or certified mail has been deleted. Notification may be sent by any reasonable means as provided in Section 1-202. The swifter, more flexible procedure of subsection (a) is appropriate to commercial storage. Compare seller's power of resale on

breach by buyer under the provisions of the Article on Sales (Section 2-706). Commercial reasonableness is a flexible concept that allows for a wide variety of actions to satisfy the rule of this section, including electronic means of posting and sale.

2. The provisions of subsections (d) and (e) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices and remain unchanged from former Section 7-210.

3. A warehouses may have recourse to an interpleader action in appropriate circumstances. See Section 7-603.

4. If a warehouse has both a warehouse lien and a security interest, the warehouse may enforce both the lien and the security interest simultaneously by using the procedures of Article 9. Section 7-210 adopts as its touchstone "commercial reasonableness" for the enforcement of a warehouse lien. Following the procedures of Article 9 satisfies "commercial reasonableness."

Cross Reference:

Sections 2-706, 7-403, 7-603 and Part 6 of Article 9.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Conspicuous". Section 1-201.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Notification". Section 1-202.
"Notifies". Section 1-202.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Warehouse". Section 7-102.

CASE NOTES

The purpose of the requirement of subdivision (2)(f) that the advertisement must include a description of the goods is to insure that those who might be interested in buying the items will be present at the sale. Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979).

And this purpose is not adequately served by the use of the general term "household goods," where the goods to be sold include such varied items as a stereo, color TV, lawn mower, aquarium, and washing machine. Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979).

Defendant's noncompliance with subdivision (2)(f) would not invalidate the sale, but it would entitle plaintiff to whatever damages he can prove resulted from the noncompliance. Grundey v. Clark Transf. Co., 42 N.C. App. 308, 256 S.E.2d 732 (1979).

Failure to Comply with Subsection (3) Constituted Conversion. — Where defendant moving company refused to accept payment by plaintiff and continued to hold goods while mounting up storage fees, and even though plaintiff effectively satisfied the lien on his goods by giving defendant $4,800.00, defendant sold the goods, defendant's failure to comply with the requirements of subsection (3) constituted a willful violation of the requirements for sale, and the defendant was properly held liable for conversion of plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989), cert. denied, 326 N.C. 54, 389 S.E.2d 104 (1990).

OPINIONS OF ATTORNEY GENERAL

A warehouseman with liens pursuant to both Article 1 of Chapter 44A of the General Statutes and Article 7 of the Uniform Commercial Code may enforce his lien pursuant to G.S. 25-7-210 without allowing the owner a judicial hearing pursuant to G.S. 44A-4. See opinion of Attorney General to Resa L. Harris, Legal Officer, Office of the Clerk of Superior Court, Mecklenburg County, 48 N.C.A.G. 111 (1979).

PART 3.

Bills of Lading: Special Provisions.

§ 25-7-301. Liability for nonreceipt or misdescription; "said to contain"; "shipper's weight, load, and count"; improper handling.

(a) A consignee of a nonnegotiable bill of lading which has given value in good faith, or a holder to which a negotiable bill has been duly negotiated, relying upon the description of the goods in the bill or upon the date shown in the bill, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the bill indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, such as in a case in which the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown," "said to contain," "shipper's weight, load, and count," or words of similar import, if that indication is true.

(b) If goods are loaded by the issuer of a bill of lading:

(1) The issuer shall count the packages of goods if shipped in packages and ascertain the kind and quantity if shipped in bulk; and

(2) Words such as "shipper's weight, load, and count," or words of similar import indicating that the description was made by the shipper are ineffective except as to goods concealed in packages.

(c) If bulk goods are loaded by a shipper that makes available to the issuer of a bill of lading adequate facilities for weighing those goods, the issuer shall ascertain the kind and quantity within a reasonable time after receiving the shipper's request in a record to do so. In that case, "shipper's weight" or words of similar import are ineffective.

(d) The issuer of a bill of lading, by including in the bill the words "shipper's weight, load, and count," or words of similar import, may indicate that the goods were loaded by the shipper, and, if that statement is true, the issuer is not liable for damages caused by the improper loading. However, omission of such words does not imply liability for damages caused by improper loading.

(e) A shipper guarantees to an issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition, and weight, as furnished by the shipper, and the shipper shall indemnify the issuer against damage caused by inaccuracies in those particulars. This right of indemnity does not limit the issuer's responsibility or liability under the contract of carriage to any person other than the shipper. (1919, c. 65, ss. 20 to 22; C.S., ss. 302 to 304; 1965, c. 700, s. 1; 1967, c. 24, s. 12; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-301.

Changes: Changes for clarity, style and to recognize deregulation in the transportation industry.

Purposes:

1. This section continues the rules from former Section 7-301 with one substantive change. The obligations of the issuer of the bill of lading under former subsections (2) and (3) were limited to issuers who were common carriers. Subsections (b) and (c) apply the same rules to all issuers not just common carriers. This section is compatible with the policies stated in the federal Bills of Lading Act, 49 U.S.C. § 80113 (2000).

2. The language of the pre-Code Uniform Bills of Lading Act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve itself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is

that the carrier is not liable for losses caused by act or default of the shipper, which would include improper loading. D. H. Overmyer Co. v. Nelson Brantley Glass Go., 168 S.E.2d 176 (Ga. Ct. App. 1969). There was some question whether under pre-Code law a carrier was liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. Subsection (d) permits the carrier to bar, by disclosure of shipper's loading, liability to a good faith purchaser. There is no implication that decisions such as Modern Tool Corp. v. Pennsylvania R. Co., 100 F.Supp. 595 (D.N.J.1951), are disapproved.

3. This section is a restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper. The wording in this section — "contents or condition of contents of packages unknown" or "shipper's weight, load and count" — to indicate that the shipper loaded the goods or that the carrier does not know the description, condition, or contents of the loaded packages continues to be appropriate as commonly understood in the transportation industry. The reasons for this wording are as important in 2002 as when the prior section initially was approved. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the carrier concerning the goods may cause damage to the carrier. Subsection (e) therefore provides appropriate indemnity.

5. The word "freight" in the former Section 7-301 has been changed to "goods" to conform to international and domestic land transport usage in which "freight" means the price paid for carriage of the goods and not the goods themselves. Hence, changing the word "freight" to the word "goods" is a clarifying change that fits both international and domestic practice.

Cross References:

Sections 7-203, 7-309 and 7-501.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Consignee". Section 7-102.
"Document of Title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Holder". Section 1-201.
"Issuer". Section 7-102.
"Notice". Section 1-202.
"Party". Section 1-201.
"Purchaser." Section 1-201.
"Receipt of Goods". Section 2-103.
"Value". Section 1-204.

CASE NOTES

The former rule, prior to the former Bills of Lading Act, was that when goods were sent "shipper's load and count," the bill of lading was only prima facie evidence that the carrier received the goods described in it, and where the evidence showed that the loading was all done by the shipper, the burden was on the plaintiff to prove that the goods were actually delivered to the carrier. Peele v. Atlantic C.L.R.R., 149 N.C. 390, 63 S.E. 66 (1908). See Williams, Black & Co. v. Wilmington & W.R.R., 93 N.C. 42 (1885); Commercial Nat'l Bank v. Seaboard A.L.R.R., 175 N.C. 415, 95 S.E. 777 (1918), decided under former statutory provisions.

Cited in Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

§ 25-7-302. Through bills of lading and similar documents of title.

(a) The issuer of a through bill of lading, or other document of title embodying an undertaking to be performed in part by a person acting as its agent or by a performing carrier, is liable to any person entitled to recover on the bill or other document for any breach by the other person or the performing carrier of its obligation under the bill or other document. However, to the extent that the bill or other document covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation, this liability for breach by the other person or the performing carrier may be varied by agreement of the parties.

(b) If goods covered by a through bill of lading or other document of title embodying an undertaking to be performed in part by a person other than the issuer are received by that person, the person is subject, with respect to its own performance while the goods are in its possession, to the obligation of the issuer. The person's obligation is discharged by delivery of the goods to another person pursuant to the bill or other document and does not include liability for breach by any other person or by the issuer.

(c) The issuer of a through bill of lading or other document of title described in subsection (a) of this section is entitled to recover from the performing carrier, or other person in possession of the goods when the breach of the obligation under the bill or other document occurred:

(1) The amount it may be required to pay to any person entitled to recover on the bill or other document for the breach, as may be evidenced by any receipt, judgment, or transcript of judgment; and

(2) The amount of any expense reasonably incurred by the issuer in defending any action commenced by any person entitled to recover on the bill or other document for the breach. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-302.

Changes: To conform to current terminology and for style.

Purposes:

1. This section continues the rules from former Section 7-302 without substantive change. The term "performing carrier" is substituted for the term "connecting carrier" to conform the terminology of this section with terminology used in recent UNCITRAL and OAS proposals concerning transportation and through bills of lading. This change in terminology is not substantive. This section is compatible with liability on carriers under federal law. See 49 U.S.C. §§ 11706, 14706 and 15906.

The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any performing carrier and to make it clear that any such performing carrier holds the goods on terms which are defined by the document of title even though such performing carrier did not issue the document. Since the performing carrier does hold the goods on the terms of the document, it must honor a proper demand for delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for non-delivery and limitations of liability provided for the original bailee who issued the bill. Unlike the original bailee-issuer, the performing carrier's responsibility is limited to the period while the goods are in its possession. The section does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multipurpose documents may come into use, e.g., combination warehouse receipts and bills of lading. As electronic documents of title come into common usage, storage documents (e.g. warehouse receipts) and transportation documents (e.g. bills of lading) may merge seamlessly into one electronic document that can serve both the storage and transportation segments of the movement of goods.

3. Under subsection (a) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (c) gives the issuer appropriate rights of recourse.

4. Despite the broad language of subsection (a), Section 7-302 is subject to preemption by federal laws and treaties. Section 7-103. The precise scope of federal preemption in the transportation sector is a question determined under federal law.

Cross Reference:

Section 7-103.

Definitional Cross References:

"Agreement". Section 1-201.
"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Party". Section 1-201.
"Person". Section 1-201.

§ 25-7-303. Diversion; reconsignment; change of instructions.

(a) Unless the bill of lading otherwise provides, a carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods, without liability for misdelivery, on instructions from:

(1) The holder of a negotiable bill;
(2) The consignor on a nonnegotiable bill, even if the consignee has given contrary instructions;
(3) The consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the tangible bill or in control of the electronic bill; or
(4) The consignee on a nonnegotiable bill, if the consignee is entitled as against the consignor to dispose of the goods.

(b) Unless instructions described in subsection (a) of this section are included in a negotiable bill of lading, a person to whom the bill is duly negotiated may hold the bailee according to the original terms. (1919, c. 65, ss. 9, 10; C.S., ss. 291, 292; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-303.

Changes: To accommodate electronic documents and for style.

Purposes:

1. Diversion is a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. This section continues former Section 7-303's safe harbor rules for carriers in situations involving diversion and adapts those rules to electronic documents of title. This section works compatibly with Section 2-705. Carriers may as a business matter be willing to accept instructions from consignees in which case the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods under subsection (a)(4). The section imposes no duty on carriers to undertake diversion. The carrier is of course subject to the provisions of mandatory filed tariffs as provided in Section 7-103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee-buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a non- negotiable bill of lading. Thus if the carrier, upon instructions from the consignor, returns the goods to the consignor, the consignee may recover the goods from the consignor or the consignor's insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee. The rights that arise between the consignor-seller and the consignee-buyer out of a contract for the sale of goods are governed by Article 2.

Cross References:

Point 1: Sections 2-705 and 7-103.
Point 2: Article 2, Sections 7-403 and 7-504(3).

Definitional Cross References:

"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Consignee". Section 7-102.
"Consignor". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Notice". Section 1-202.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Term". Section 1-201.

§ 25-7-304. Tangible bills of lading in a set.

(a) Except as customary in international transportation, a tangible bill of lading may not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(b) If a tangible bill of lading is lawfully issued in a set of parts, each of which contains an identification code and is expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitutes one bill.

(c) If a tangible negotiable bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to which the first due negotiation is made prevails as to both the document of title and the goods even if any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrendering its part.

(d) A person that negotiates or transfers a single part of a tangible bill of lading issued in a set is liable to holders of that part as if it were the whole set.

(e) The bailee shall deliver in accordance with Part 4 of this Article against the first presented part of a tangible bill of lading lawfully issued in a set. Delivery in this manner discharges the bailee's obligation on the whole bill. (1919, c. 65, s. 4; C.S., s. 286; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-304.

Changes: To limit bills in a set to tangible bills of lading and to use terminology more consistent with modern usage.

Purposes:

1. Tangible bills of lading in a set are still used in some nations in international trade. Consequently, a tangible bill of lading part of a set could be at issue in a lawsuit that might come within Article 7. The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other international tangible bills of lading. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this Article. Tangible bills of lading in a set are prohibited in domestic trade.

2. Electronic bills of lading in domestic or international trade will not be issued in a set given the requirements of control necessary to deliver the bill to another person. An electronic bill of lading will be a single, authoritative copy. Section 7-106. Hence, this section differentiates between electronic bills of lading and tangible bills of lading. This section does not prohibit electronic data messages about goods in transit because these electronic data messages are not the issued bill of lading. Electronic data messages contain information for the carrier's management and handling of the cargo but this information for the carrier's use is not the issued bill of lading.

Cross Reference:

Section 7-103, 7-303 and 7-106.

Definitional Cross References:

"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Holder". Section 1-201.
"Person". Section 1-201.
"Receipt of goods". Section 2-103.

§ 25-7-305. Destination bills.

(a) Instead of issuing a bill of lading to the consignor at the place of shipment, a carrier, at the request of the consignor, may procure the bill to be issued at destination or at any other place designated in the request.

(b) Upon request of any person entitled as against a carrier to control the goods while in transit and on surrender of possession or control of any outstanding bill of lading or other receipt covering the goods, the issuer, subject to G.S. 25-7-105, may procure a substitute bill to be issued at any place designated in the request. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-305.

Changes: To accommodate electronic bills of lading and for style.

Purposes:

1. Subsection (a) continues the rules of former Section 7-305(1) without substantive change. This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await the consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e.g. a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank. Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when the buyer honors the draft. Normally seller would act through its own bank in San Francisco, which would extend credit in reliance on the airline's contract to deliver a bill to the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills. Whether a performing carrier will act as issuing agent is left to agreement between carriers.

2. Subsection (b) continues the rule from former Section 7-305(2) with accommodation for electronic bills of lading. If the substitute bill changes from an electronic to a tangible medium or vice versa, the issuance of the substitute bill must comply with Section 7-105 to give the substitute bill validity and effect.

Cross Reference:
Section 7-105.

Definitional Cross References:
"Bill of lading". Section 1-201.
"Consignor". Section 7-102.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Receipt of goods". Section 2-103.

§ 25-7-306. Altered bills of lading.

An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor. (1919, c. 65, s. 13; C.S., s. 295; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-306.

Changes: None.

Purposes:

An unauthorized alteration or filling in of a blank, whether made with or without fraudulent intent, does not relieve the issuer of its liability on the document as originally executed. This section applies to both tangible and electronic bills of lading, applying the same rule to both types of bills of lading. The control concept of Section 7-106 requires that any changes to the electronic document of title be readily identifiable as authorized or unauthorized. Section 7-306 should be compared to Section 7-208 where a different rule applies to the unauthorized filling in of a blank for tangible warehouse receipts.

Cross Reference:
Sections 7-106 and 7-208.

Definitional Cross References:
"Bill of lading". Section 1-201.
"Issuer". Section 7-102.

§ 25-7-307. Lien of carrier.

(a) A carrier has a lien on the goods covered by a bill of lading or on the proceeds thereof in its possession for charges after the date of the carrier's receipt of the goods for storage or transportation, including demurrage and terminal charges, and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. However, against a purchaser for value of a negotiable bill of lading, a carrier's lien is limited to charges stated in the bill or the applicable tariffs or, if no charges are stated, a reasonable charge.

(b) A lien for charges and expenses under subsection (a) of this section on goods that the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to those charges and expenses. Any other lien under subsection (a) of this section is effective against the consignor and any person that permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked authority.

(c) A carrier loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver. (1919, c. 65, s. 25; C.S., s. 307; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-307.

Changes: Expanded to cover proceeds of the goods transported.

Purposes:

1. The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehouses by the first sentence of Section 7-209(a) and extends that lien to the proceeds of the goods as long as the carrier has possession of the proceeds. But because carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7-209(a) and (b) are omitted. Carriers may utilize Article 9 to obtain a security interest and become a secured party or a carrier may agree to limit its lien rights in a transportation agreement with the shipper. As the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, subsection (b) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority. If the carrier does not know or have reason to know of the bailor's lack of authority, the carrier has a lien under this section against any person so long as the conditions of subsection (b) are satisfied. In light of the crucial mental element, Sections 7-307 and 9-333 combine to give priority to a carrier's lien over security interests in the goods. In this regard, the judicial decision in In re Sharon Steel Corp., 25 U.C.C. Rep.2d 503, 176 B.R. 384 (W.D. Pa. 1995) is correct and is the controlling precedent.

2. The reference to charges in this section means charges relating to the bailment relationship for transportation. Charges does not mean that the bill of lading must state a specific rate or a specific amount. However, failure to state a specific rate or a specific amount has legal consequences under the second sentence of subsection (a).

3. The carrier's specific lien under this section is a possessory lien. See subsection (c). Part 3 of Article 7 does not require any particular form for a bill of lading. The carrier's lien arises when the carrier has issued a bill of lading.

Cross References:

Point 1: Sections 7-209, 9-109 and 9-333.
Point 3. Section 7-202 and 7-209.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Consignor". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Value". Section 1-204.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

CASE NOTES

Cited in In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

§ 25-7-308. Enforcement of carrier's lien.

(a) A carrier's lien on goods may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The carrier sells goods in a commercially reasonable manner if the carrier sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or otherwise sells in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but shall be retained by the carrier, subject to the terms of the bill of lading and this Article.

(c) A carrier may buy at any public sale pursuant to this section.

(d) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against which the lien was valid, despite the carrier's noncompliance with this section.

(e) A carrier may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to whom the carrier would have been bound to deliver the goods.

(f) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(g) A carrier's lien may be enforced pursuant to either subsection (a) of this section or the procedure set forth in G.S. 25-7-210(b).

(h) A carrier is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-308.

Changes: To conform language to modern usage and for style.

Purposes:

This section is intended to give the carrier an enforcement procedure of its lien coextensive with that given the warehouse in cases other than those covering noncommercial storage by the warehouse. See Section 7-210 and comments.

Cross Reference:

Section 7-210.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Good faith". Section 1-201. [7-102]
"Goods". Section 7-102.
"Notification". Section 1-202.
"Notifies". Section 1-202.
"Person". Section 1-201.

"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.

§ 25-7-309. Duty of care; contractual limitation of carrier's liability.

(a) A carrier that issues a bill of lading, whether negotiable or nonnegotiable, shall exercise the degree of care in relation to the goods which a reasonably careful person would exercise under similar circumstances. This subsection does not affect any statute, regulation, or rule of law that imposes liability upon a common carrier for damages not caused by its negligence.

(b) Damages may be limited by a term in the bill of lading or in a transportation agreement that the carrier's liability may not exceed a value stated in the bill or transportation agreement if the carrier's rates are dependent upon value and the consignor is afforded an opportunity to declare a higher value and the consignor is advised of the opportunity. However, such a limitation is not effective with respect to the carrier's liability for conversion to its own use.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the shipment may be included in a bill of lading or a transportation agreement. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-309.

Changes: References to tariffs eliminated because of deregulation, adding reference to transportation agreements, and for style.

Purposes:

1. A bill of lading may also serve as the contract between the carrier and the bailor. Parties in their contract should be able to limit the amount of damages for breach of that contract including breach of the duty to take reasonable care of the goods. The parties cannot disclaim by contract the carrier's obligation of care. Section 1-302.

Federal statutes and treaties for air, maritime and rail transport may alter the standard of care. These federal statutes and treaties preempt this section when applicable. Section 7-103. Subsection (a) does not impair any rule of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (b), however, applies to the common carrier's liability as an insurer as well as to liability based on negligence. Subsection (b) allows the term limiting damages to appear either in the bill of lading or in the parties' transportation agreement. Compare 7-204(b). Subsection (c) allows the parties to agree to provisions regarding time and manner of presenting claims or commencing actions if the provisions are either in the bill of lading or the transportation agreement. Compare 7-204(c). Transportation agreements are commonly used to establish agreed terms between carriers and shippers that have an on-going relationship.

2. References to public tariffs in former Section 7-309(2) and (3) have been deleted in light of the modern era of deregulation. See Comment 2 to Section 7-103. If a tariff is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section. As governed by contract law, parties may incorporate by reference the limits on the amount of damages or the reasonable provisions as to the time and manner of presenting claims set forth in applicable tariffs, e.g. a maximum unit value beyond which goods are not taken or a disclaimer of responsibility for undeclared articles of extraordinary value.

3. As under former Section 7-309(2), subsection (b) provides that a limitation of damages is ineffective if the carrier has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the carrier's own use. "Conversion to its own use" is narrower than the idea of conversion generally. Art Masters Associates, Ltd. v. United Parcel Service, 77 N.Y.2d 200, 567 N.E.2d 226 (1990); See, Kemper Ins. Co. v. Fed. Ex. Corp., 252 F.3d 509 (1st Cir), cert. denied 534 U.S. 1020 (2001) (opinion interpreting federal law).

4. As used in this section, damages may include damages arising from delay in delivery. Delivery dates and times are often specified in the parties' contract. See Section 7-403.

Cross Reference:
Sections 1-302, 7-103, 7-204, 7-403.

Definitional Cross References:
"Action". Section 1-201.

"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Consignor". Section 7-102.
"Document of Title". Section 1-102.
"Goods". Section 7-102.
"Value". Section 1-204.

PART 4.

Warehouse Receipts and Bills of Lading: General Obligations.

§ 25-7-401. Irregularities in issue of receipt or bill or conduct of issuer.

The obligations imposed by this Article on an issuer apply to a document of title even if:

(1) The document does not comply with the requirements of this Article or of any other statute, rule, or regulation regarding its issuance, form, or content;
(2) The issuer violated laws regulating the conduct of its business;
(3) The goods covered by the document were owned by the bailee when the document was issued; or
(4) The person issuing the document is not a warehouse but the document purports to be a warehouse receipt. (1917, c. 37, s. 20; 1919, c. 65, ss. 21, 22; C.S., ss. 303, 304, 4060; 1931, c. 358, s. 1; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-401.

Changes: Changes for style only.

Purposes:
The bailee's liability on its document despite non-receipt or misdescription of the goods is affirmed in Sections 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregularities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this Article. For example, a bailee will not be permitted to avoid its obligation to deliver the goods (Section 7-403) or its obligation of due care with respect to them (Sections 7-204 and 7-309) by taking the position that no valid "document" was issued because it failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Tate v. Action Moving & Storage, Inc., 383 S.E.2d 229 (N.C. App. 1989), rev. denied 389 S.E.2d 104 (N.C. 1990). Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the duty. See Section 7-103.

Cross References:
Sections 7-103, 7-203, 7-204, 7-301, 7-309.

Definitional Cross References:
"Bailee". Section 7-102.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Person". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

CASE NOTES

Warehouse Receipt. — Even though "Household Goods Descriptive Inventory" was probably irregular as a warehouse receipt, this irregularity did not relieve defendant of his duty to act as a reasonably careful person in relation to plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

§ 25-7-402. Duplicate document of title; overissue.

A duplicate or any other document of title purporting to cover goods already represented by an outstanding document of the same issuer does not confer any right in the goods, except as provided in the case of tangible bills of lading in a set of parts, overissue of documents for fungible goods, substitutes for lost, stolen, or destroyed documents, or substitute documents issued pursuant to G.S. 25-7-105. The issuer is liable for damages caused by its overissue or failure to identify a duplicate document by a conspicuous notation. (1917, c. 37, s. 6; 1919, c. 65, s. 5; C.S., ss. 287, 4047; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-402.

Changes: Changes to accommodate electronic documents.

Purposes:

1. This section treats a duplicate which is not properly identified as a duplicate like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages against the person that made the deception possible, except in the cases noted in the section. But parts of a tangible bill lawfully issued in a set of parts are not "overissue" (Section 7-304). Of course, if the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the issuer is not liable for preparing and delivering such a duplicate copy.

Section 7-105 allows documents of title to be reissued in another medium. Re-issuance of a document in an alternative medium under Section 7-105 requires that the original document be surrendered to the issuer in order to make the substitute document the effective document. If the substitute document is not issued in compliance with section 7-105, then the document should be treated as a duplicate under this section.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable document acquires only the rights of its transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e.g. negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. Section 7-503 provides for cases of conflict between documents of different issuers.

Cross References:

Point 1: Sections 7-105, 7-207, 7-304, and 7-601.

Point 3: Section 7-503.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Conspicuous". Section 1-201.
"Document of title". Section 1-201.
"Fungible goods." Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Right". Section 1-201.

§ 25-7-403. Obligation of bailee to deliver; excuse.

(a) A bailee shall deliver the goods to a person entitled under a document of title if the person complies with subsections (b) and (c) of this section, unless and to the extent that the bailee establishes any of the following:

(1) Delivery of the goods to a person whose receipt was rightful as against the claimant;
(2) Damage to or delay, loss, or destruction of the goods for which the bailee is not liable;
(3) Previous sale or other disposition of the goods in lawful enforcement of a lien or on a warehouse's lawful termination of storage;
(4) The exercise by a seller of its right to stop delivery pursuant to G.S. 25-2-705 or by a lessor of its right to stop delivery pursuant to G.S. 25-2A-526;

(5) A diversion, reconsignment, or other disposition pursuant to G.S. 25-7-303;
(6) Release, satisfaction, or any other personal defense against the claimant; or
(7) Any other lawful excuse.

(b) A person claiming goods covered by a document of title shall satisfy the bailee's lien if the bailee so requests or if the bailee is prohibited by law from delivering the goods until the charges are paid.

(c) Unless a person claiming the goods is a person against whom the document of title does not confer a right under G.S. 25-7-503(a):
(1) The person claiming under a document shall surrender possession or control of any outstanding negotiable document covering the goods for cancellation or indication of partial deliveries; and
(2) The bailee shall cancel the document or conspicuously indicate in the document the partial delivery or the bailee is liable to any person to whom the document is duly negotiated. (1917, c. 37, ss. 8, 9, 11, 12, 36; 1919, c. 65, ss. 8, 9, 11, 12, 26; C.S., ss. 290, 291, 293, 294, 308, 4048, 4049, 4051, 4052, 4076; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-403.

Changes: Definition in former Section 7-403(4) moved to Section 7-102; bracketed language in former Section 7-403(1)(b) deleted; added cross reference to Section 2A-526; changes for style.

Purposes:

1. The present section, following former Section 7-403, is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the pre-Code uniform acts now find their place as "excuse" under subsection (a).

2. The principal case covered by subsection (a)(1) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse facility and takes a negotiable receipt, the warehouse is not liable on the receipt if it has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See Section 7-503(a). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner receiving delivery would not be rightful as against a holder to whom the negotiable document was duly negotiated, and delivery to the owner would not give the bailee a defense against such a holder. See Sections 7-502(a)(2), 7-503(a)(1).

3. Subsection (a)(2) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this Act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers and other bailees by the regulatory state laws preserved by Section 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by Sections 7-204 and 7-309 of this Article.

The bracketed language found in former Section 7-403(1)(b) has been deleted thereby leaving the allocations of the burden of going forward with the evidence and the burden of proof to the procedural law of the various states.

Subsection (a)(4) contains a cross reference to both the seller's and the lessor's rights to stop delivery under Article 2 and Article 2A respectively.

4. As under former Section 7-403, there is no requirement that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of its lien when asked to deliver, and only in case this request is refused is it justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases. Subsection (b) must be read in conjunction with the priorities given to the warehouse lien and the carrier lien under Section 7-209 and 7-307, respectively. If the parties are in dispute about whether the request for payment of the lien is legally proper, the bailee

may have recourse to interpleader. See Section 7-603.

5. Subsection (c) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in subsection (a)(1) of this section and in Section 7-503(a). Subsection (c) is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

6. When courts are considering subsection (a)(7), "any other lawful excuse," among others, refers to compliance with court orders under Sections 7-601, 7-602 and 7-603.

Cross References:

Point 2: Sections 7-502 and 7-503.

Point 3: Sections 2-705, 2A-526, 7-103, 7-204, and 7-309 and 10-103.

Point 4: Sections 7-209, 7-307 and 7-603.

Point 5: Section 7-503(1).

Point 6: Sections 7-601, 7-602, and 7-603.

Definitional Cross References:

"Bailee". Section 7-102.
"Conspicuous". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Goods". Section 7-102.
"Lessor". Section 2A-103.
"Person". Section 1-201.
"Receipt of goods". Section 2-103.
"Right". Section 1-201.
"Terms". Section 1-201.
"Warehouse". Section 7-102.

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Law.

I. GENERAL CONSIDERATION.

Cited in Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided under prior statutory provisions.*

Consignee Must Produce Bill on Demand. — The failure or refusal of consignee to produce, upon the carrier's demand, a bill of lading for a prepaid shipment of goods in the carrier's possession is ordinarily a valid defense to an action to recover of the carrier the value of a shipment which has never been delivered, but the burden is upon the carrier to prove that such demand has been made and not complied with. Jeans v. Seaboard A.L.R.R., 164 N.C. 224, 80 S.E. 242 (1913).

Possession of Bill Is Sufficient Evidence of Ownership. — An order bill of lading indorsed by the shipper, in the possession of the plaintiff, is sufficient evidence of the plaintiff's ownership of the bill and of the goods for which the bill was issued. Temple v. Southern R.R., 190 N.C. 438, 129 S.E. 815 (1925).

If It Is Indorsed. — Where shipper paid the draft and obtained the bill of lading, but failed to have it indorsed by a certain bank as required by the terms of the bill, the carrier was not liable for failure to deliver the goods. Killingsworth v. Norfolk S.R.R., 171 N.C. 47, 87 S.E. 947 (1916).

§ 25-7-404. No liability for good-faith delivery pursuant to document of title.

A bailee that in good faith has received goods and delivered or otherwise disposed of the goods according to the terms of a document of title or pursuant to this Article is not liable for the goods even if:

(1) The person from whom the bailee received the goods did not have authority to procure the document or to dispose of the goods; or

(2) The person to whom the bailee delivered the goods did not have authority to receive the goods. (1917, c. 37, s. 10; 1919, c. 65, s. 10; C.S., ss. 292, 4050; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-404.

Changes: Changes reflect the definition of good faith in Section 1-201 [7-102] and for style.

Purposes:

This section uses the test of good faith, as defined in Section 1-201 [7-102], to continue the policy of former Section 7-404. Good faith now means "honesty in fact and the observance of reasonable commercial standards of fair dealing." The section states explicitly that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen that in good faith perform obligations that they have assumed and that generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document. Of course, in appropriate circumstances, a bailee may use interpleader or other dispute resolution process. See Section 7-603.

Cross Reference:

Section 7-603.

Definitional Cross References:

"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Person". Section 1-201.
"Receipt of goods". Section 2-103.
"Term". Section 1-201.

PART 5.

WAREHOUSE RECEIPTS AND BILLS OF LADING: NEGOTIATION AND TRANSFER.

§ 25-7-501. Form of negotiation and requirements of due negotiation.

(a) The following rules apply to a negotiable tangible document of title:

(1) If the document's original terms run to the order of a named person, the document is negotiated by the named person's indorsement and delivery. After the named person's indorsement in blank or to bearer, any person may negotiate the document by delivery alone.

(2) If the document's original terms run to bearer, it is negotiated by delivery alone.

(3) If the document's original terms run to the order of a named person and it is delivered to the named person, the effect is the same as if the document had been negotiated.

(4) Negotiation of the document after it has been indorsed to a named person requires indorsement by the named person and delivery.

(5) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a monetary obligation.

(b) The following rules apply to a negotiable electronic document of title:

(1) If the document's original terms run to the order of a named person or to bearer, the document is negotiated by delivery of the document to another person. Indorsement by the named person is not required to negotiate the document.

(2) If the document's original terms run to the order of a named person and the named person has control of the document, the effect is the same as if the document had been negotiated.

(3) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves taking delivery of the document in settlement or payment of a monetary obligation.

(c) Indorsement of a nonnegotiable document of title neither makes it negotiable nor adds to the transferee's rights.

(d) The naming in a negotiable bill of lading of a person to be notified of the arrival of the goods does not limit the negotiability of the bill or constitute notice to a purchaser of the bill of any interest of that person in the goods. (1917, c. 37, ss. 37 to 40, 47; 1919, c. 65, ss. 3, 7, 27 to 30, 37; C.S., ss. 285, 289, 309 to 312, 319, 4077 to 4080, 4087; 1931, c. 358, ss. 2, 3; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-501.

Changes: To accommodate negotiable electronic documents of title.

Purposes:

1. Subsection (a) has been limited to tangible negotiable documents of title but otherwise remains unchanged in substance from the rules in former Section 7-501. Subsection (b) is new and applies to negotiable electronic documents of title. Delivery of a negotiable electronic document is through voluntary transfer of control. Section 1-201 definition of "delivery." The control concept as applied to negotiable electronic documents of title is the substitute for both possession and indorsement as applied to negotiable tangible documents of title. Section 7-106.

Article 7 does not separately define the term "duly negotiated." However, the elements of "duly negotiated" are set forth in subsection (a)(5) for tangible documents and (b)(3) for electronic documents. As under former Section 7-501, in order to effect a "due negotiation" the negotiation must be in the "regular course of business or financing" in order to transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not its own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession or control appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not their own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of subsections (a)(5) or (b)(3).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor itself may not have such rights to pass, and even though the transferor may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting, the effective wrongful disposition to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy: it is also clearly outside the range of regular course.

Any notice on the document sufficient to put a merchant on inquiry as to the "regular course" quality of the transaction will frustrate a "due negotiation". Thus irregularity of the document or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A pre-existing claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent, the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation."

2. Negotiation under this section may be made by any holder no matter how the holder acquired possession or control of the document.

3. Subsections (a)(3) and (b)(2) make explicit a matter upon which the intent of the pre-Code law was clear but the language somewhat obscure: a negotiation results from a delivery to a

banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course."

4. This Article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by Uniform Commercial Code Article 3. But the reason of the provisions of this Act (Section 1-307) on the prima facie authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this Act to authorize a purchaser to indulge the presumption of regularity if the courts were not also called upon to do so. Allocations of the burden of going forward with the evidence and the burden of proof are left to the procedural law of the various states.

5. Subsections (c) and (d) are unchanged from prior law and apply to both tangible and electronic documents of title.

Cross References:

Sections 1-307, 7-502 and 7-503.

Definitional Cross References:

"Bearer". Section 1-201.
"Control". Section 7-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Holder". Section 1-201.
"Notice". Section 1-202.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Value". Section 1-204.

CASE NOTES

Indorsed Warehouse Receipts Are Negotiable by Delivery. — Warehouse receipts, indorsed by the owner of the cotton and by the superintendent of the warehouse, are negotiable by delivery, and when taken as collateral confer upon the holder the position of a bona fide holder for value. Lacy v. Globe Indem. Co., 189 N.C. 24, 126 S.E. 316 (1925), decided under former statutory provisions.

§ 25-7-502. Rights acquired by due negotiation.

(a) Subject to G.S. 25-7-205 and G.S. 25-7-503, a holder to which a negotiable document of title has been duly negotiated acquires thereby:

(1) Title to the document;
(2) Title to the goods;
(3) All rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and
(4) The direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by the issuer except those arising under the terms of the document or under this Article, but in the case of a delivery order, the bailee's obligation accrues only upon the bailee's acceptance of the delivery order, and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(b) Subject to G.S. 25-7-503, title and rights acquired by due negotiation are not defeated by any stoppage of the goods represented by the document of title or by surrender of the goods by the bailee and are not impaired even if:

(1) The due negotiation or any prior due negotiation constituted a breach of duty;
(2) Any person has been deprived of possession of a negotiable tangible document or control of a negotiable electronic document by misrepresentation, fraud, accident, mistake, duress, loss, theft, or conversion; or
(3) A previous sale or other transfer of the goods or document has been made to a third person. (1917, c. 37, ss. 41, 47 to 49; 1919, c. 65, ss. 31, 37 to 39; C.S., ss. 313, 319 to 321, 4081, 4087 to 4089; 1931, c. 358, s. 3; 1965, c. 700, s. 1; 1998-217, s. 4(b); 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-502.

Changes: To accommodate electronic documents of title and for style.

Purpose:

1. This section applies to both tangible and electronic documents of title. The elements of duly negotiated, which constitutes a due negotiation, are set forth in Section 7-501. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the owner of the document and the goods have been brought together in the next section (Section 7-503).

2. Subsection (a)(3) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is estopped as against the holder of the document.

3. The explicit statement in subsection (a)(4) of the bailee's direct obligation to the holder precludes the defense that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as non-negligent destruction even though not apparent on the document. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also Section 7-503(b) and Comment.

4. Subsection (b) continues the law which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in subsection (a), but it has been included since such explicit reference was provided under former Section 7-502 to preserve the right of a purchaser by due negotiation. The listing is not exhaustive. The language "any stoppage" is included lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

Cross References:
Sections 7-103, 7-205, 7-403, 7-501, and 7-503.

Definitional Cross References:
"Bailee". Section 7-102.
"Control". Section 7-106.
"Delivery". Section 1-201.
"Delivery order". Section 7-102.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Fungible". Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Issuer". Section 7-102.
"Person". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Warehouse receipt". Section 1-201.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

CASE NOTES

***Editor's Note.** — Many of the cases cited below were decided under prior statutory provisions.*

Determining Priority of Claims. — In situations where there are actual goods, and there are conflicting claims either to them or to the documents, this section and G.S. 25-7-503 and 25-7-504 determine the priority of these claims. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

For hypothetical examples of the manner in which this section and G.S. 25-7-504 are intended to work in determining the priorities of competing claims, see Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

The primary purpose of this section and G.S. 25-7-504 is to determine the priority of competing claims to valid documents and goods actually stored in a warehouse and to determine the issuer's liability for a misdelivery of goods actually received by it. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Generally, a holder of negotiable warehouse receipts acquired through "due negotiation" will receive paramount title not only to the documents but also to the goods represented by them, the purpose of UCC, Article 7, Part 5, being to facilitate the negotiability and integrity of negotiable receipts. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Purchase of Warehouse Receipt Without Knowledge of Lien Senior in Time. — Under § 105-241, a lien for State taxes on personal property is not enforceable against a bona fide purchaser for value, except upon a levy upon such property under an execution or a tax warrant; but when a tax lien is perfected, it is, by § 105-376 (c), superior to all other liens or rights prior or subsequent in time. By subsection (1) (c) of this section a bona fide purchaser of a warehouse receipt acquires good title against a lien senior in time of which the purchaser had no notice. Thus, an enforceable lien on oil stored in North Carolina would not arise until it was executed on; but it could not be attached when a warehouse receipt therefor was in the hands of one who purchased it not knowing of the lien. Davenport v. Ralph N. Peters & Co., 386 F.2d 199 (4th Cir. 1967).

The negotiation of a warehouse receipt is not impaired by the fact that such negotiation was a breach of duty on the part of the person making the negotiation, if the person to whom the receipt was negotiated took same for value, in good faith, and without notice of the breach of duty. Harris v. Fairley, 232 N.C. 551, 61 S.E.2d 616 (1950). See Lacy v. Globe Indem. Co., 189 N.C. 24, 126 S.E. 316 (1925).

Indorsee of Bill of Lading May Recover for Damage to Goods Before Negotiation. — The person to be notified on shipment to order of a consignor had title for purposes of a suit to recover damages and the statutory penalty, as fully as if the carrier had contracted with him direct, upon the presentation of the bill of lading properly indorsed and his tender thereof in good faith to the carrier, the former Bills of Lading Act being remedial of the common law that there was no contractual relation between him and the carrier that would permit recovery for causes accruing before he had paid the draft and had the bill of lading assigned to him. Watts v. Norfolk S. Ry., 183 N.C. 12, 110 S.E. 582 (1922).

Instruction Omitting Element of Transferee's "Good Faith" Held Erroneous. — An instruction to the effect that the burden was upon the transferee to show that he took the warehouse receipts in controversy for value and without notice of any defect would be held to be reversible error for omitting the element of good faith, notwithstanding a prior correct instruction, when the question of good faith was the focal point of the controversy upon plaintiff's evidence that the transferrer was its agent and transferred the receipts in discharge of his personal liability to the transferee on an unpaid check. Locke Cotton Mills Co. v. Pate Cotton Co., 232 N.C. 186, 59 S.E.2d 570 (1950).

§ 25-7-503. Document of title to goods defeated in certain cases.

(a) A document of title confers no right in goods against a person that before issuance of the document had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with:
  a. Actual or apparent authority to ship, store, or sell;
  b. Power to obtain delivery under G.S. 25-7-403; or
  c. Power of disposition under G.S. 25-2-403, 25-2A-304(2), 25-2A-305(2), 25-9-320, or 25-9-321(c) or other statute or rule of law; or

(2) Acquiesce in the procurement by the bailor or its nominee of any document.

(b) Title to goods based upon an unaccepted delivery order is subject to the rights of any person to whom a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. That title may be defeated under G.S. 25-7-504 to the same extent as the rights of the issuer or a transferee from the issuer.

(c) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of any person to which a bill issued by the freight forwarder is duly negotiated. However, delivery by the carrier in accordance with Part 4 of this Article pursuant to its own bill of lading discharges the carrier's obligation to deliver. (1917, c. 37, s. 41; 1919, c. 65, s. 31; C.S., ss. 313, 4081; 1965, c. 700, s. 1; 2000-169, s. 20; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-503.

Changes: Changes to cross-reference to Article 2A and for style.

Purposes:

1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to the thief's own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or mortgagee does not require active consent under subsection (a)(2) and knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat the landlord's or the mortgagee's rights as against one who takes by due negotiation of a negotiable document. In re Sharon Steel, 176 B.R. 384 (Bankr. W.D. Pa. 1995); In re R.V. Segars Co, 54 B.R. 170 (Bankr. S.C. 1985); In re Jamestown Elevators, Inc., 49 B.R. 661 (Bankr. N.D. 1985).

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in its duty to sell for cash, the goods are "entrusted" to the factor "with actual ... authority ... to sell" under subsection (a)(1), and if the factor procures a negotiable document of title it can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to it simply for safekeeping or storage may be entrusted under circumstances which give the factor "apparent authority to ship, store or sell" under subsection (a)(1), or power of disposition under Section 2-403, 2A-304(2), 2A-305(2), 7-205, 9-320, or 9-321(c) or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See Section 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. This Act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to the agent's own order and then proceed to misappropriate the negotiable document of title that embodies the goods. This Act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safeguard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchase be in good faith and without notice. See Section 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment, the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See Section 2-403. Both in policy and under the language of subsection (a)(1) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

This comment 1 should be considered in interpreting delivery, entrustment or acquiescence in application of Section 7-209(c)).

2. Under subsection (a) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in subsection (a)(1) or (2). Thus the rights of a transferee of a non-negotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in that person's procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under Section 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under subsection (b) in much the same way that the rights of a transferee may be defeated under Section 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. Section 7-504(b)(2). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under subsection (c) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's document of title, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and the freight forwarder has in all probability issued a document of title. But the carrier is protected in following the terms of its own bill of lading.

Cross References:

Point 1: Sections 1-103, 2-403, 2A-304(2), 2A-305(2), 7-205, 7-209, 7-501, 9-320, 9-321(c), and 9-331.

Point 2: Sections 7-402 and 7-504.

Point 3: Sections 7-402, 7-403 and 7-404.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Delivery order". Section 7-102.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Goods". Section 7-102.
"Person". Section 1-201.
"Right". Section 1-201.
"Warehouse receipt". Section 1-201.

CASE NOTES

Determining Priority of Claims. — In situations where there are actual goods, and there are conflicting claims either to them or to the documents, G.S. 25-7-502 through 25-7-504 determine the priority of these claims. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977), (decided under prior law).

§ 25-7-504. Rights acquired in absence of due negotiation; effect of diversion; stoppage of delivery.

(a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the document has been delivered but not duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey.

(b) In the case of a transfer of a nonnegotiable document of title, until but not after the bailee receives notice of the transfer, the rights of the transferee may be defeated:

(1) By those creditors of the transferor which could treat the transfer as void under G.S. 25-2-402 or G.S. 25-2A-308;

(2) By a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of the buyer's rights;

(3) By a lessee from the transferor in ordinary course of business if the bailee has delivered the goods to the lessee or received notification of the lessee's rights; or

(4) As against the bailee, by good-faith dealings of the bailee with the transferor.

(c) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver the goods to the consignee defeats the consignee's title to the goods if the goods have been delivered to a buyer in ordinary course of business or a lessee in ordinary course of business and, in any event, defeats the consignee's rights against the bailee.

(d) Delivery of the goods pursuant to a nonnegotiable document of title may be stopped by a seller under G.S. 25-2-705 or a lessor under G.S. 25-2A-526, subject to the requirements of due notification in those sections. A bailee that honors the seller's or lessor's instructions is entitled to be indemnified by the seller or lessor against any resulting loss or expense. (1917, c. 37, s. 42; 1919, c. 65, s. 32; c. 290; C.S., ss. 314, 4082; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-504.

Changes: To include cross-references to Article 2A and for style.

Purposes:

1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than the transferor has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which the transferor has or has "actual authority to convey." Thus, where a negotiable document of title is being transferred the operation of the principle of estoppel

is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare Section 2-403 on good faith purchase of goods.) This section applies to both tangible and electronic documents of title.

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if the purchaser had purchased the goods themselves. True, the purchaser's rights are not subject to defeat by attachment of the goods or surrender of them to the purchaser's transferor (contrast subsection (b)); but on the other hand, the purchaser cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to its consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the Article of this Act on Sales (Section 2-403), whereas the same payment made in good faith against an unendorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize its status by compelling indorsement of the document (see Section 7-506).

2. As in the case of transfer — as opposed to "due negotiation" — of negotiable documents, subsection (a) empowers the transferor of a nonnegotiable document to transfer only such rights as the transferor has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than the transferor actually has. Subsection (b) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee. New subsection (b)(3) provides for the rights of a lessee in the ordinary course.

Subsection (b)(2)&(3) require delivery of the goods. Delivery of the goods means the voluntary transfer of physical possession of the goods. See amended 2-103.

3. Subsection (c) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under pre-Code passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection. The same result should obtain if the substituted consignee is a lessee in ordinary course. The extent of the lessee's interest in the goods is less than a buyer's interest in the goods. However, as against the first consignee and the lessee in ordinary course as the substituted consignee, the lessee's rights in the goods as granted under the lease are superior to the first consignee's rights.

4. Subsection (d) gives the carrier an express right to indemnity where the carrier honors a seller's request to stop delivery.

5. Section 1-202 gives the bailee protection, if due diligence is exercised where the bailee's organization has not had time to act on a notification.

Cross References:

Point 1: Sections 2-403 and 7-506.

Point 2: Sections 2-403 and 2A-304.

Point 3: Sections 7-303, 7-403(a)(5) and 7-404.

Point 4: Sections 2-705 and 7-403(a)(4).

Point 5: Section 1-202.

Definitional Cross References:

"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Buyer in ordinary course of business". Section 1-201.
"Consignee". Section 7-102.
"Consignor". Section 7-102.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Honor". Section 1-201.
"Lessee in ordinary course". Section 2A-103.
"Notification" Section 1-202.
"Purchaser". Section 1-201.
"Rights". Section 1-201.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

CASE NOTES

Determining Priority of Claims. — In situations where there are actual goods, and there are conflicting claims either to them or to the documents, G.S. 25-7-502 through 25-7-504 determine the priority of these claims. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

For hypothetical examples of the manner in which this section and G.S. 25-7-502 are intended to work in determining the priorities of competing claims, see Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

The primary purpose of this section and G.S. 25-7-502 is to determine the priority of competing claims to valid documents and goods actually stored in a warehouse and to determine the issuer's liability for a misdelivery of goods actually received by it. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Generally, a holder of negotiable warehouse receipts acquired through "due negotiation" will receive paramount title not only to the documents but also to the goods represented by them, the purpose of UCC, Article 7, Part 5, being to facilitate the negotiability and integrity of negotiable receipts. Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Cited in Branch Banking & Trust Co. v. Gill, 286 N.C. 342, 211 S.E.2d 327 (1975).

§ 25-7-505. Indorser not guarantor for other parties.

The indorsement of a tangible document of title issued by a bailee does not make the indorser liable for any default by the bailee or previous indorsers. (1917, c. 37, s. 45; 1919, c. 65, s. 35; C.S., ss. 317, 4085; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-505.

Changes: Limited to tangible documents of title.

Purposes:

This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Electronic documents of title will be transferred by delivery of control. Section 7-106. The indorsement of a tangible document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circumstances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See Section 7-502(a)(4) as to negotiable delivery orders. However, even in such a case, once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.

Cross Reference:

Sections 7-106 and 7-502.

Definitional Cross References:

"Bailee". Section 7-102.
"Document of title". Section 1-201.
"Party". Section 1-201.

§ 25-7-506. Delivery without indorsement; right to compel indorsement.

The transferee of a negotiable tangible document of title has a specifically enforceable right to have its transferor supply any necessary indorsement, but the transfer becomes a negotiation only as of the time the indorsement is supplied. (1917, c. 37, s. 43; 1919, c. 65, s. 33; C.S., ss. 315, 4083; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-506.

Changes: Limited to tangible documents of title.

Purposes:

1. This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Electronic documents of title will be transferred by delivery of control. Section 7-106. From a commercial point of view the intention to transfer a tangible negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. Further, the preceding section and the Comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that delivery of a tangible document of title without the necessary indorsement is effective as a transfer, the transferee, of course, has not regularized its position until such indorsement is supplied. Until this is done the transferee cannot claim rights under due negotiation within the requirements of this Article (Section 7-501(a)(5)) on "due negotiation". Similarly, despite the transfer to the transferee of the transferor's title, the transferee cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See Section 7-403(c).

Cross References:

Point 1: Sections 7-106 and 7-505.

Point 2: Sections 7-501(a)(5) and 7-403(c).

Definitional Cross References:

"Document of title". Section 1-201.

"Rights". Section 1-201.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

CASE NOTES

Applied in Branch Banking & Trust Co. v. Gill, 293 N.C. 164, 237 S.E.2d 21 (1977).

Cited in Branch Banking & Trust Co. v. Gill, 286 N.C. 342, 211 S.E.2d 327 (1975).

§ 25-7-507. Warranties on negotiation or delivery of document of title.

If a person negotiates or delivers a document of title for value, otherwise than as a mere intermediary under G.S. 25-7-508, unless otherwise agreed, the transferor, in addition to any warranty made in selling or leasing the goods, warrants to its immediate purchaser only that:

(1) The document is genuine;

(2) The transferor does not have knowledge of any fact that would impair the document's validity or worth; and

(3) The negotiation or delivery is rightful and fully effective with respect to the title to the document and the goods it represents. (1917, c. 37, s. 44; 1919, c. 65, s. 34; C.S., ss. 316, 4084; 1965, c. 700, s. 1; 1998-217, s. 4(c); 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-507

Changes: Substitution of the word "delivery" for the word "transfer," reference leasing transactions and style.

Purposes:

1. Delivery of goods by use of a document of title does not limit or displace the ordinary obligations of a seller or lessor as to any warranties regarding the goods that arises under other law. If the transfer of documents attends or follows the making of a contract for the sale or lease of goods, the general obligations on warranties as to the goods (Sections 2-312 through 2-318 and Sections 2A-210 through

2A-316) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary, including a collecting bank, are stated in Section 7-508.

Cross References:

Point 1: Sections 2-312 through 2-318 and 2A-310-through 2A-316.

Point 2: Section 7-508.

Definitional Cross References:

"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Genuine". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Value". Section 1-204.

§ 25-7-508. Warranties of collecting bank as to documents of title.

A collecting bank or other intermediary known to be entrusted with documents of title on behalf of another or with collection of a draft or other claim against delivery of documents warrants by the delivery of the documents only its own good faith and authority even if the collecting bank or other intermediary has purchased or made advances against the claim or draft to be collected. (1917, c. 37, s. 46; 1919, c. 65, s. 36; C.S., ss. 318, 4086; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-508.

Changes: Changes for style only.

Purposes:

1. To state the limited warranties given with respect to the documents accompanying a documentary draft.

2. In warranting its authority a collecting bank or other intermediary only warrants its authority from its transferor. See Section 4-203. It does not warrant the genuineness or effectiveness of the document. Compare Section 7-507.

3. Other duties and rights of banks handling documentary drafts for collection are stated in Article 4, Part 5. On the meaning of draft, see Section 4-104 and Section 5-102, comment 11.

Cross References:

Sections 4-104, 4-203, 4-501 through 4-504, 5-102, and 7-507.

Definitional Cross References:

"Collecting bank". Section 4-105.
"Delivery". Section 1-201.
"Document of title". Section 1-102.
"Documentary draft". Section 4-104.
"Intermediary bank". Section 4-105.
"Good faith". Section 1-201 [7-102.]

§ 25-7-509. Adequate compliance with commercial contract.

Whether a document of title is adequate to fulfill the obligations of a contract for sale, a contract for lease, or the conditions of a letter of credit is determined by Article 2, 2A, or 5 of this Chapter. (1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-509.

Changes: To reference Article 2A.

Purposes:

To cross-refer to the Articles of this Act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

Cross References:

Articles 2, 2A and 5.

Definitional Cross References:

"Contract for sale". Section 2-106.
"Document of title". Section 1-201.
"Lease". Section 2A-103.

PART 6.

WAREHOUSE RECEIPTS AND BILLS OF LADING: MISCELLANEOUS PROVISIONS.

§ 25-7-601. Lost, stolen, or destroyed documents of title.

(a) If a document of title is lost, stolen, or destroyed, a court may order delivery of the goods or issuance of a substitute document, and the bailee may without liability to any person comply with the order. If the document was negotiable, a court may not order delivery of the goods or issuance of a substitute document without the claimant's posting security unless it finds that any person that may suffer loss as a result of nonsurrender of possession or control of the document is adequately protected against the loss. If the document was nonnegotiable, the court may require security. The court may also order payment of the bailee's reasonable costs and attorneys' fees in any action under this subsection.

(b) A bailee that, without a court order, delivers goods to a person claiming under a missing negotiable document of title is liable to any person injured thereby. If the delivery is not in good faith, the bailee is liable for conversion. Delivery in good faith is not conversion if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery that files a notice of claim within one year after the delivery. (1917, c. 37, ss. 11, 14; 1919, c. 65, ss. 11, 14; C.S., ss. 293, 296, 4051, 4054; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-601.

Changes: To accommodate electronic documents; to provide flexibility to courts similar to the flexibility in Section 3-309; to update to the modern era of deregulation; and for style.

Purposes:

1. Subsection (a) authorizes courts to order compulsory delivery of the goods or compulsory issuance of a substitute document. Compare Section 7-402. Using language similar to that found in Section 3-309, courts are given discretion as to what is adequate protection when the lost, stolen or destroyed document was negotiable or whether security should be required when the lost, stolen or destroyed document was nonnegotiable. In determining whether a party is adequately protected against loss in the case of a negotiable document, the court should consider the likelihood that the party will suffer a loss. The court is also given discretion as to the bailee's costs and attorney fees. The rights and obligations of a bailee under this section depend upon whether the document of title is lost, stolen or destroyed and is in addition to the ability of the bailee to bring an action for interpleader. See Section 7-603.

2. Courts have the authority under this section to order a substitute document for either tangible or electronic documents. If the substitute document will be in a different medium than the original document, the court should fashion its order in light of the requirements of Section 7-105.

3. Subsection (b) follows prior Section 7-601 in recognizing the legality of the well established commercial practice of bailees making delivery in good faith when they are satisfied that the claimant is the person entitled under a missing (i.e. lost, stolen, or destroyed) negotiable document. Acting without a court order, the bailee remains liable on the original negotiable document and, to avoid conversion liability, the bailee may insist that the claimant provide an indemnity bond. Cf. Section 7-403.

4. Claimants on non-negotiable instruments are permitted to avail themselves of the subsection (a) procedure because straight (non-negotiable) bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement. Without a court order, a bailee may deliver, subject to Section 7-403, to a person claiming goods under a non-negotiable document that the same person claims is lost, stolen, or destroyed.

5. The bailee's lien should be protected when a court orders delivery of the goods pursuant to this section.

Cross References:
Point 1: Sections 3-309, 7-402 and 7-603.
Point 2: Section 7-105.
Point 3: Section 7-403.
Point 4: Section 7-403.
Point 5: Sections 7-209 and 7-307.

Definitional Cross References:
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Person". Section 1-201.

§ 25-7-602. Judicial process against goods covered by negotiable document of title.

Unless a document of title was originally issued upon delivery of the goods by a person that did not have power to dispose of them, a lien does not attach by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless possession or control of the document is first surrendered to the bailee or the document's negotiation is enjoined. The bailee may not be compelled to deliver the goods pursuant to process until possession or control of the document is surrendered to the bailee or to the court. A purchaser of the document for value without notice of the process or injunction takes free of the lien imposed by judicial process. (1917, c. 37, s. 25; 1919, c. 65, s. 23; C.S., ss. 305, 4065; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision:
Former Section 7-602.

Changes: Changes to accommodate electronic documents of title and for style.

Purposes:

1. The purpose of the section is to protect the bailee from conflicting claims of the document of title holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail unless, in effect, the judgment creditors immobilize the negotiable document of title through the surrender of possession of a tangible document or control of an electronic document. However, if the document of title was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.

2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

Cross References:
Sections 7-106 and 7-501 through 7-503.

Definitional Cross References:
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Notice". Section 1-202.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Value". Section 1-204.

CASE NOTES

Attachment Against Property in Possession of Warehouseman. — North Carolina law does not permit an attachment against property in the possession of a warehouseman who has issued a negotiable warehouse receipt therefor, unless the receipt is first surrendered or its negotiation is enjoined. Davenport v. Ralph N. Peters & Co., 386 F.2d 199 (4th Cir. 1967).

§ 25-7-603. Conflicting claims; interpleader.

If more than one person claims title to or possession of the goods, the bailee is excused from delivery until the bailee has a reasonable time to ascertain the validity of the adverse claims or to commence an action for interpleader. The bailee may assert an interpleader either in defending an action for nondelivery of the goods or by original action. (1917, c. 37, ss. 17, 18; 1919, c. 65, ss. 17, 18; C.S., ss. 299, 300, 4057, 4058; 1965, c. 700, s. 1; 2006-112, s. 25.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-603.

Changes: Changes for style only.

Purposes:

1. The section enables a bailee faced with conflicting claims to the goods to compel the claimants to litigate their claims with each other rather than with the bailee. The bailee is protected from legal liability when the bailee complies with court orders from the interpleader. See e.g. Northwestern National Sales, Inc. v. Commercial Cold Storage, Inc., 162 Ga. App. 741, 293 S.E.2d. 30 (1982).

2. This section allows the bailee to bring an interpleader action but does not provide an exclusive basis for allowing interpleader. If either state or federal procedural rules allow an interpleader in other situations, the bailee may commence an interpleader under those rules. Even in an interpleader to which this section applies, the state or federal process of interpleader applies to the bailee's action for interpleader. For example, state or federal interpleader statutes or rules may permit a bailee to protect its lien or to seek attorney's fees and costs in the interpleader action.

Cross Reference:
Point 1: Section 7-403.

Definitional Cross References:
"Action". Section 1-201.
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Reasonable time". Section 1-205.

ARTICLE 8.

Investment Securities.

(Revised)

NORTH CAROLINA COMMENT

This article is based upon Revised Article 8 of the Uniform Commercial Code (hereinafter "Revised Article 8"), which was adopted in 1994 by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Revised Article 8 updates the prior version of Article 8 of the Uniform Commercial Code to provide a modern legal structure for the system of holding securities through brokers, banks, and other securities intermediaries (hereinafter "indirect holding system") that has developed in the past few decades.

Revised Article 8 defines the nature of the property interest of the customer in the indirect conceptual structure and provisions of the prior version of Article 8 relating to the direct holding of certificated and uncertificated securities, while eliminating ambiguities and inconsistencies that have been found in the prior version of the Article. Provisions governing the creation and perfection of security interests in investment securities, whether held directly or indirectly, are not set out in Revised Article 8 but have been returned to Article 9.

The revised Official Comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute appear in Revised Article 8 under the heading "Official Comment".

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PART 1.

SHORT TITLE AND GENERAL MATTERS.

§ 25-8-101. Short title.

This Article may be cited as Uniform Commercial Code — Investment Securities. (1965, c. 700, s. 1; 1997-181, s. 1.)

Editor's Note. — Session Laws 1997-181, s. 1, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, rewrote Article 8 of Chapter 25 of the General Statutes. Historical citations and case annotations to sections in the former Article 8 have been added to corresponding sections in new Article 8 as recodified. At the end of Article 8 are tables showing comparable sections and their disposition in new Article 8.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Legal Periodicals. — For symposium on the Uniform Commercial Code in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For symposium on the North Carolina Commercial Code, see 18 Wake Forest L. Rev. 161 (1982).

For comment, "Fraud-on-the-Market Theory and Thinly-Traded Securities Under Rule 10b-5: How Does a Court Decide If a Stock Market Is Efficient?", see 25 Wake Forest L. Rev. 223 (1990).

For note, "Close Corporation Stock as a 'Security' Under Uniform Commercial Code Article 8: North Carolina Embraces the Statute of Frauds in Stancil v. Stancil," see 69 N.C.L. Rev. 1432 (1991).

For 1997 legislative survey, see 20 Campbell L. Rev. 401.

§ 25-8-102. Definitions.

(a) In this Article:
- (1) "Adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset.
- (2) "Bearer form", as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.
- (3) "Broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.
- (4) "Certificated security" means a security that is represented by a certificate.
- (5) "Clearing corporation" means:
  - (i) A person that is registered as a "clearing agency" under the federal securities laws;
  - (ii) A federal reserve bank; or
  - (iii) Any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its

activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(6) "Communicate" means to:
  (i) Send a signed writing; or
  (ii) Transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(7) "Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of G.S. 25-8-501(b)(2)or (3), that person is the entitlement holder.

(8) "Entitlement order" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(9) "Financial asset", except as otherwise provided in G.S. 25-8-103, means:
  (i) A security;
  (ii) An obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or
  (iii) Any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.

As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

(10) Repealed by Session Laws 2006-112, s. 20, effective October 1, 2006.

(11) "Indorsement" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security or granting a power to assign, transfer, or redeem it.

(12) "Instruction" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(13) "Registered form", as applied to a certificated security, means a form in which:
  (i) The security certificate specifies a person entitled to the security; and
  (ii) A transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(14) "Securities intermediary" means:
  (i) A clearing corporation; or
  (ii) A person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(15) "Security", except as otherwise provided in G.S. 25-8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:
  (i) Which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) Which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) Which:

(A) Is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) Is a medium for investment and by its terms expressly provides that it is a security governed by this Article.

(16) "Security certificate" means a certificate representing a security.

(17) "Security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 of this Article.

(18) "Uncertificated security" means a security that is not represented by a certificate.

(b) Other definitions applying to this Article and the sections in which they appear are:

"Appropriate person"	G.S. 25-8-107.
"Control"	G.S. 25-8-106.
"Delivery"	G.S. 25-8-301.
"Investment company security"	G.S. 25-8-103.
"Issuer"	G.S. 25-8-201.
"Overissue"	G.S. 25-8-210.
"Protected purchaser"	G.S. 25-8-303.
"Securities account"	G.S. 25-8-501.

(c) In addition, Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article.

(d) The characterization of a person, business, or transaction for purposes of this Article does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule. (1965, c. 700, s. 1; 1973, c. 497, s. 3; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(a); 1997-181, s. 1; 2006-112, s. 20.)

AMENDED OFFICIAL COMMENT (1999 ED.)

***Editor's Note.** — This Amended Official Comment accompanies the revision to Article 9, effective July 1, 2001.*

1. "Adverse Claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the second party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as *Fallon v. Wall Street Clearing Corp.*, 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and *Pentech Intl. v. Wall St. Clearing Co.*, 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contract to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract of restitution, A may, have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(14) probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 definition when they perform functions that would bring them within the federal securities law definition if it did not have the cause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i), and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade of course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in formal agreement. The term communicate is used in Sections 8-102(a)(8) (definition of entitlement order), 8-102(a)(12) (definition of instruction), and 8-403 (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the position. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders. Moreover, an entitlement holder may be acting for another person as a nominee, agent, trustee, or in another capacity. Unless the entitlement holder is itself acting as a securities intermediary for the other person, in which case the other person would be an entitlement holder with respect to the securities entitlement, the relationship between an entitlement holder and another person for whose benefit the entitlement holder holds a securities entitlement is governed by other law.

8. "Entitlement orders." The term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. An entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., the delivery of a securities certificate registered in the name of the former entitlement holder). As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b).

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "security account" in Section 8-501, sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial assets does not, without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, question of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8?" Rather, one must analyze whether relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 for purposes of the application Article 8 of Section 10-203, which provides that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1-203 obligation as it applies to contract and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 and 8-503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8-308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a). The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107.

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting functions while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting to the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledge securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that broker provide margin loans to their customer.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by the ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security — that is, the underlying intangible interest not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest in divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possible that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 security. This opt-in provision allows for deliberate expansion of the scope of Article 8.

Section 8-103 contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Section 8-104(c) and 8-503. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Bank"	Section 1-201(4).
"Person"	Section 8-201(30).
"Send"	Section 1-201(38).
"Signed"	Section 1-201(39).
"Writing"	Section 1-201(46).

Editor's Note. — Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 20, effective October 1, 2006, repealed subdivision (a)(10).

Legal Periodicals. — For 1997 legislative survey, see 20 Campbell L. Rev. 401.

CASE NOTES

Editor's Note. — *The case below was decided under this Article of the Uniform Commercial Code prior to its 1997 revision.*

Shares of Close Corporation Securities. — Shares of stock in closely held corporation were investment "securities" under the definition of that term in former subdivision (1)(a) of this section. Stancil v. Stancil, 326 N.C. 766, 392 S.E.2d 373 (1990).

Transfer by Indorsement and Delivery. — Trustees of the decedent's trust acquired legal title to one of two stock certificates the decedent owned when the decedent signed it over to the trust and delivered it to the trustees; however, as to the other stock certificate, which was not found until after the decedent's death, and which was neither indorsed nor delivered to the trustees, there was no transfer of legal title to that stock certificate by the decedent to the trustees and the asset belonged to the decedent's estate. Therefore, the trial court did not err in distributing the first stock certificate to the trust and the second stock certificate to the estate and dividing the respective dividends accordingly. In re Estate of Washburn, 158 N.C. App. 457, 581 S.E.2d 148, 2003 N.C. App. LEXIS 1148 (2003).

§ 25-8-103. Rules for determining whether certain obligations and interests are securities or financial assets.

(a) A share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this Article, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this Article and not by Article 3 of this Chapter, even though it also meets the requirements of that Article. However, a negotiable instrument governed by Article 3 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(f) A commodity contract, as defined in G.S. 25-9-102(a)(15), is not a security or financial asset.

(g) A document of title is not a financial asset unless G.S. 25-8-102(a)(9)(iii) applies. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1; 1998-217, s. 5; 2000-169, s. 21; 2006-112, s. 43.)

OFFICIAL COMMENT

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102. The Section 8-102 definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 definitions to investment products not covered by this section.

2. Subsection (a) establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded or securities exchanges or in securities exchanges or in securities markets. Thus, shares of closely held are Article 8 securities.

3. Subsection (b) establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance of redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 refer to "redemptions" as well as "transfers," to ensure that the Article 8 rules on such matters as signature guaranties, Section 8-306, assurances, Sections 8-402 and 8-507, and effectiveness, Section 8-107, apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 mechanics.

4. Subsection (c) is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) to partnership interests. Subsection (c) establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in secu-

rities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Partnership interests or shares of limited liability companies are included by the broader term "financial asset." Thus, they are held through a securities account, the indirect holding system rules of Part 5 apply, and the interest of a person who hold them through such an account in a security entitlement.

5. Subsection (d) deals with the line between Article negotiable instruments and Article 8 investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 definition is covered by Article 8 rather than Article 3, even though it also meets the definition of negotiable instrument. However, subsection (d) provides that an Article 3 negotiable instrument is a "financial asset" so that the indirect holding system rules applies if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) excludes commodity contracts from all of Article 8. However, the Article 9 rules on security interest in investment property do apply to security interests in commodity positions. See Section 9-115 and Comment 8 thereto. "Commodity contract" is defined in Section 9-115.

Definitional Cross References:

"Clearing corporation"	Section 8-102(a)(5).
"Commodity contract"	Section 9-115.
"Financial asset"	Section 8-102(a)(9).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 43, effective October 1, 2006, added subsection (g).

§ 25-8-104. Acquisition of security or financial asset or interest therein.

(a) A person acquires a security or an interest therein, under this Article, if:

(1) The person is a purchaser to whom a security is delivered pursuant to G.S. 25-8-301; or

(2) The person acquires a security entitlement to the security pursuant to G.S. 25-8-501.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this Article, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5 of this Article, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in G.S. 25-8-503.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule, or agreement to transfer, deliver, present, surrender, exchange, or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (a) or (b) of this section. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8. In that sense, it describes the scope of Article 8. Subsection (a) describes the two ways that a person may acquire a security or interest therein under this Article: (1) By delivery (Section 8-301), and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301, describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) specifies how a person may acquire an interest under Article 8 in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3, not by Article 8. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3, not Article 8, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 rules specifying how negotiable instruments are transferred. The rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 a security entitlement is treated as a sui generis form of property interest.

3. Subsection (d) is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures, and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion, or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a

tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d) takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References:

"Delivery"	Section 8-301.
"Financial asset"	Section 8-102(a)(9).
"Person"	Section 1-201(30).
"Purchaser"	Section 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-105. Notice of adverse claim.

(a) A person has notice of an adverse claim if:

(1) The person knows of the adverse claim;

(2) The person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) The person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) One year after a date set for presentment or surrender for redemption or exchange; or

(2) Six months after a date set for payment of money against presentation or surrender of the certificate if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) Whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(2) Is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under Article 9 of this Chapter is not notice of an adverse claim to a financial asset. (1965, c. 700; s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502, and 8-510, provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) — which provides that a person has notice of a fact if "from all the facts and circumstances known to him or her at the time in question he or she has reason to know that it exists" — does not apply to the interpretation of "notice of adverse claims." The Section

1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1). "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefor, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) is a particularization of this general principle.

3. Paragraph (a)(1) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) as actual knowledge.

4. Paragraph (a)(2) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See *May v. Chapman,* 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); *Goodman v. Simonds,* 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a nonprofessional.

The second prong of the willful blindness test of paragraph (a)(2) turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303. The same result has been reached under the prior version of Article 8. See *First Nat'l Bank of Cicero v. Lewco Securities,* 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) provides explicitly for some situations involving purchase from one described or identifiable as a representative.

Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See *State Bank of Binghamton v. Bache,* 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefor disqualified from protected purchaser status under Section 8-303. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this article on staleness as notice of defects or defenses of an issuer (Section 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a).

8. Subsection (d) provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Financial asset"	Section 8-102(a)(9).
"Knowledge"	Section 1-201(25).
"Person"	Section 1-201(30).
"Purchaser"	Sections 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Representative"	Section 1-201(35).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-106. Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) The certificate is endorsed to the purchaser or in blank by an effective endorsement; or

(2) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) The uncertificated security is delivered to the purchaser; or

(2) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) The purchaser becomes the entitlement holder;

(2) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or

(3) Another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) of this section has control, even if the registered owner in the case of subsection

(c) of this section or the entitlement holder in the case of subsection (d) of this section retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subdivision (c) (2) or (d) (2) of this section without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1; 2000-169, s. 22.)

AMENDED OFFICIAL COMMENT (1999 ED.)

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchasers); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); 9-314 (perfection of security interests); 9-328 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301. Subsection (b) provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301, provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1), securities can be "delivered" to a purchaser. Section 8-301(b) provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See Section 8-207. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party — so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) makes this point explicit. The subsection (c)(2) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) specifies the means by which a purchaser can obtain control of a security entitlement. Three mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary. Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser if no further consent by the entitlement holder is required. Under subsection (d)(2), control may be achieved even though the original entitlement holder remains as the entitlement holder. Finally, a purchaser may obtain control under subsection (d)(3) if another person has control

and the person acknowledges that it has control on the purchaser's behalf. Control under subsection (d)(3) parallels the delivery of certificated securities and uncertificated securities under Section 8-301. Of course, the acknowledging person cannot be the debtor.

This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the application of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha's account. Alpha has control of the 1000 shares under subsection (d)(1). Although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Able has agreed to act on Alpha's entitlement orders because, as between Able and Alpha, Alpha has become the entitlement holder. See Section 8-506.

Example 2. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Alpha has control of the 1000 shares under subsection (d)(1). As in Example 1, although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha also has the right to direct dispositions. Alpha has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha's account at Clearing Corporation. As in Example 1, Alpha has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta's account at Clearing Corporation. Beta credits the position to Alpha's account with Beta. As in Example 2, Alpha has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha has the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co., a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

Example 9. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Beta Bank agrees with Alpha to act as Alpha's collateral agent with respect to the security entitlement. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta also has the right to direct dispositions. Because Able has agreed that it will comply with entitlement orders originated by Beta without further consent by Debtor, Beta has control of the security entitlement (see Example 3). Because Beta has control on behalf of Alpha, Alpha also has control under subsection (d)(3). It is not necessary for Able to enter into an agreement directly with Alpha or for Able to be aware of Beta's agency relationship with Alpha.

5. For a purchaser to have "control" under subsection (c)(2) or (d)(2), it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) or (d)(2) because the issuer or securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) or (d)(1) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, to direct the disposition of the uncertificated security or security entitlement, or otherwise to give instructions or entitlement orders. (As explained in Section 8-102, Comment 8, an entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., by delivery of a securities certificate registered in the name of the former entitlement holder).) Subsection (f) is included to make clear the general point stated in subsections (c) and (d) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control. Nor is there a requirement that the purchaser's powers be unconditional, provided that further consent of the entitlement holder is not a condition.

Example 10. Debtor grants to Alpha Bank and to Beta Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. By agreement among the parties, Alpha's security interest is senior and Beta's is junior. Able agrees to act on the entitlement orders of either Alpha or Beta. Alpha and Beta each has control under subsection (d)(2). Moreover, Beta has control notwithstanding a term of Able's agreement to the effect that Able's obligation to act on Beta's entitlement orders is conditioned on Alpha's consent. The crucial distinction is that Able's agreement to act on Beta's entitlement orders is not conditioned on Debtor's further consent.

Example 11. Debtor grants to Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Able agrees to act on the entitlement orders of Alpha, but Alpha's right to give entitlement orders to the securities intermediary is conditioned on the Debtor's default. Alternatively, Alpha's right to give entitlement orders is conditioned upon Alpha's statement to Able that Debtor is in default. Because Able's agreement to act on Alpha's entitlement orders is not conditioned on Debtor's further consent, Alpha has control of the securities entitlement under either alternative.

In many situations, it will be better practice for both the securities intermediary and the purchaser to insist that any conditions relating in any way to the entitlement holder be effective only as between the purchaser and the entitlement holder. That practice would avoid the risk that the securities intermediary could be caught between conflicting assertions of the entitlement holder and the purchaser as to whether the conditions in fact have been met. Nonetheless, the existence of unfulfilled conditions effective against the intermediary would not preclude the purchaser from having control.

Definitional Cross References:

"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Delivery"	Section 8-301.
"Effective"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Purchaser"	Section 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

Editor's Note. — The comments to this section contain technical amendments approved through July, 2000.

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

For 1997 legislative survey, see 20 Campbell L. Rev. 401.

§ 25-8-107. Whether indorsement, instruction, or entitlement order is effective.

(a) "Appropriate person" means:

(1) With respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) With respect to an instruction, the registered owner of an uncertificated security;

(3) With respect to an entitlement order, the entitlement holder;

(4) If the person designated in subdivision (1), (2), or (3) of this subsection is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) If the person designated in subdivision (1), (2), or (3) of this subsection lacks capacity, the designated person's guardian, conservator, or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction, or entitlement order is effective if:

(1) It is made by the appropriate person;

(2) It is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under G.S. 25-8-106(c)(2) or (d)(2); or

(3) The appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction, or entitlement order made by a representative is effective even if:

(1) The representative has failed to comply with a controlling instrument or with the law of the state having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) The representative's action in making the indorsement, instruction, or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction, or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction, or entitlement order is determined as of the date the indorsement, instruction, or entitlement order is made, and an indorsement, instruction, or entitlement order does not become ineffective by reason of any later change of circumstances. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 only if the purchaser obtains "control." Section 8-106 provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" indorsement.

2. Subsection (a) provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitle-

ment orders of instructions. Paragraph 2 of subsection (b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d), and (e) supplement the general rule of subsection (b) on effectiveness. The term "representative," used in subsections (c) and (d), is defined in Section 1-201(35).

4. Subsection (c) provides that an indorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

> *Example 1.* Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303. Under Section 8-404, the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

> *Example 2.* Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser.

Subsection (d) provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

> *Example 3.* Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d), because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306.

6. Subsection (e) provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

> *Example 4.* Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4). Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404.

Definitional Cross References:

"Entitlement order"	Section 8-102(a)(8).
"Financial asset"	Section 8-102(a)(9).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Representative"	Section 1-201(35).
"Securities account"	Section 8-501.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-108. Warranties in direct holding.

(a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:

(1) The certificate is genuine and has not been materially altered;
(2) The transferor or indorser does not know of any fact that might impair the validity of the security;
(3) There is no adverse claim to the security;
(4) The transfer does not violate any restriction on transfer;
(5) If the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and
(6) The transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:

(1) The instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;
(2) The security is valid;
(3) There is no adverse claim to the security; and
(4) At the time the instruction is presented to the issuer:
  (i) The purchaser will be entitled to the registration of transfer;
  (ii) The transfer will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction;
  (iii) The transfer will not violate any restriction on transfer; and
  (iv) The requested transfer will otherwise be effective and rightful.

(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:

(1) The uncertificated security is valid;
(2) There is no adverse claim to the security;
(3) The transfer does not violate any restriction on transfer; and
(4) The transfer is otherwise effective and rightful.

(d) A person who indorses a security certificate warrants to the issuer that:

(1) There is no adverse claim to the security; and
(2) The indorsement is effective.

(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:

(1) The instruction is effective; and
(2) At the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment, or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (g) of this section.

(i) Except as otherwise provided in subsection (g) of this section, a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (a) through (f) of this section. A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (a) or (b) of this section, and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer. (1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsections (a), (b), and (c) deal with warranties by security transferors to purchasers. Subsections (d) and (e) deal with warranties by security transferors to issuers. Subsection (f) deals with presentment warranties.

2. Subsection (a) specifies the warranties made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4), and (5) make explicit several key points that are implicit in the general warranty of paragraph (6) that the transfer is effective and rightful. Subsection (b) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2). Subsections (d) and (e) give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) limits the warranties given by a secured party who redelivers a certificate. Subsection (i) specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Appropriate person"	Section 8-107.
"Broker"	Section 8-102(a)(3).
"Certificated security"	Section 8-102(a)(4).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Person"	Section 1-201(30).
"Purchaser"	Sections 1-201(33) & 8-116.
"Secured party"	Section 9-105(1)(m).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-109. Warranties in indirect holding.

(a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) The entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) There is no adverse claim to the security entitlement.

(b) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in G.S. 25-8-108(a) or (b).

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in G.S. 25-8-108(a) or (b). (1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108. If the securities intermediary in turns delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i).

3. As with the Section 8-108 warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Appropriate person"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Instruction"	Section 8-102(a)(12).
"Person"	Section 1-201(30).
"Securities account"	Section 8-501.
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-110. Applicability; choice of law.

(a) The local law of the issuer's jurisdiction, as specified in subsection (d) of this section, governs:

(1) The validity of a security;

(2) The rights and duties of the issuer with respect to registration of transfer;

(3) The effectiveness of registration of transfer by the issuer;

(4) Whether the issuer owes any duties to an adverse claimant to a security; and

(5) Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in subsection (e) of this section, governs:

(1) Acquisition of a security entitlement from the securities intermediary;

(2) The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subdivisions (a)(2) through (5) of this section.

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this Part, this Article, or this Chapter, that jurisdiction is the securities intermediary's jurisdiction.

(2) If subdivision (1) of this subsection does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(3) If neither subdivision (1) nor subdivision (2) of this section applies and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(4) If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

(5) If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account. (1997-181, s. 1; 2000-169, s. 23.)

AMENDED OFFICIAL COMMENT (1999 ED.)

1. This section deals with applicability and choice of law issues concerning Article 8. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determine the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do

not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws Section 4.

2. Subsection (a) provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 determine the issuer's rights and duties. Paragraph (1) of subsection (a) provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of Article 8, concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8, concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a), rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1). The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 and Comments thereto.

Although subsection (a) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. Neither this section nor Section 1-105 deals with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) permits specification of the securities intermediary's jurisdiction by agreement. In the absence of such a specification, the law chosen by the parties to govern the securities account determines the securities intermediary's jurisdiction. See paragraph (2). Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of the parties' selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-305. The remaining paragraphs in subsection (e) contain additional default rules for determining the securities intermediary's jurisdiction.

Subsection (f) makes explicit a point that is implicit in the Article 8 description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c), New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that Illinois is the securities intermediary's (Able's) jurisdiction. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed by French law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8. Article 8, however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115. Subsection (b)(3) of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8, Section 8-115 as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-305.

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Agreement"	Section 1-201(3).
"Certificated security"	Section 8-102(a)(4).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Issuer"	Section 8-201.
"Person"	Section 1-201(30).
"Purchase"	Section 1-201(32).
"Securities intermediary"	Section 8-102(a)(14).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-111. Clearing corporation rules.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this Article and affects another party who does not consent to the rule. (1997-181, s. 1.)

OFFICIAL COMMENT

1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509, and Section 1-102(3) and (4). Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality or reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References:

“Clearing corporation” Section 8-102(a)(5).

§ 25-8-112. Creditor’s legal process.

(a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in subsection (d) of this section. However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (d) of this section.

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor’s securities account is maintained, except as otherwise provided in subsection (d) of this section.

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security, or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process. (1997-181, s. 1.)

OFFICIAL COMMENT

1. In dealing with certificated securities the instrument itself is the vital thing, and therefor a valid levy cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome-Portland Copper Mining Co.,* 29 Ariz. 560, 243 P. 400 (1926). Therefor, although injunctive relief is provided in subsection (e) so that creditors may use this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and *Shaffer v. Heitner,* 433 U.S. 186 (1977).

3. Subsection (c) provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115.

4. Subsection (d) provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Secured party"	Section 9-105(1)(m).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-113. Statute of frauds inapplicable.

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making. (1997-181, s. 1.)

OFFICIAL COMMENT

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References:

"Action"	Section 1-201(1).
"Contract"	Section 1-201(11).
"Writing"	Section 1-201(46).

§ 25-8-114. Evidentiary rules concerning certificated securities.

The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted. (1997-181, s. 1.)

OFFICIAL COMMENT

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308, to actions on certificated securities governed by this Article. An "action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References:

"Action"	Section 1-201(1).
"Burden of establishing"	Section 1-201(8).
"Certificated security"	Section 8-102(a)(4).
"Indorsement"	Section 8-102(a)(11).
"Issuer"	Section 8-201.
"Presumed"	Section 1-201(31).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-115. Securities intermediary and others not liable to adverse claimant.

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) Took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(2) Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) In the case of a security certificate that has been stolen, acted with notice of the adverse claim. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Other provisions of Article 8 protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries — the

"conduits" in the indirect holding system — and brokers or other agents or bailees — the "conduits" in the direct holding system. The following examples illustrate its operation:

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts G.S. 235. See also UCC Section 7-404.

3. Except as provided in paragraph 3, this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 protects Able and Baker from liability. The protections of Section 8-115 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law G.S. 134. Other sections of the UCC embody a similar policy. See Sections 3-602 and 5-114(2)(b).

Paragraph (1) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3) denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 indirect holding system rules — that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

> *Example 5.* Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115, Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.
>
> *Example 6.* Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115, Clearing Corporation is not liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating of the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts G.S. 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References:

"Broker"	Section 8-102(a)(3).
"Effective"	Section 8-107.
"Entitlement order"	Section 8-102(a)(8).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-116. Securities intermediary as purchaser for value.

A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section 1-201(44)(d) should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501. Section 8-116 specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502, which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References:

"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

PART 2.

ISSUE AND ISSUER.

§ 25-8-201. Issuer.

(a) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(1) Places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation, or other interest in its

property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate;

(2) Creates a share, participation, or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) Directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) Becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained. (1899, c. 733, ss. 29, 60 to 62; Rev., ss. 2177, 2209 to 2211; C.S., ss. 3009, 3041 to 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(b); 1997-181, s. 1.)

OFFICIAL COMMENT

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15).

2. Subsection (b) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (d) of Section 8-202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407.

Definitional Cross References:

"Person"	Section 1-201(30).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-202. Issuer's responsibility and defenses; notice of defect or defense.

(a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for

value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(2) Subdivision (1) of this subsection applies to an issuer that is a government or governmental subdivision, agency, or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in G.S. 25-8-205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly. (1899, c. 733, ss. 23, 28, 56, 57, 61, 62; Rev., ss. 2171, 2176, 2205, 2206, 2210, 2211; C.S., ss. 3003, 3008, 3037, 3038, 3042, 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers, and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds,* 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini v. Family Theatre Corporation,* 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Airmotive,* 119 F.2d 267 (C.C.A.Alaska 1941).

2. The rule in subsection (a) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) does not apply.

3. The penultimate sentence of subsection (a) and all of subsection (b) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: First, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as *Tommie v. City of Gadsden,* 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. *Chaffee County v. Potter,* 142 U.S. 355 (1892); *Town of Oregon v. Jennings,* 119 U.S. 74 (1886); *Gunnison County Commissioners v. Rollins,* 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. *Anthony v. County of Jasper,* 101 U.S. 693 (1879); *Town of South Ottawa v. Perkins,* 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) Substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210, regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as, and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the

principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for value without notice. Section 8-202 describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-203. Staleness as notice of defect or defense.

After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) Requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) Is not covered by subdivision (1) of this section and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 and comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-204. Effect of issuer's restriction on transfer.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) The security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) The security is uncertificated and the registered owner has been notified of the restriction. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401.

3. The policy of this section is the same as in Section 8-202. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii). B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) and comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See *Quiner v. Marblehead Social Co.,* 10 Mass. 476 (1813); *Madison Bank v. Price,* 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n,* 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal

with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Conspicuous"	Section 1-201(10).
"Issuer"	Section 8-201.
"Knowledge"	Section 1-201(25).
"Notify"	Section 1-201(26).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

CASE NOTES

Editor's Note. — *The case cited below was decided under this article of the Uniform Commercial Code prior to its 1997 revision.*

Restrictions on the transfer of stock must be stated on the certificate in order to be valid against transferees without notice. Onslow Whsle. Plumbing & Elec. Supply, Inc. v. Fisher, 60 N.C. App. 55, 298 S.E.2d 718 (1982), aff'd, 308 N.C. 540, 302 S.E.2d 632 (1983).

§ 25-8-205. Effect of unauthorized signature on security certificate.

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) An authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or

(2) An employee of the issuer, or of any of the persons listed in subdivision (1) of this section, entrusted with responsible handling of the security certificate. (1899, c. 733, s. 23; Rev., s. 2171; C.S., s. 3003; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. *See Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co.,* 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia,* 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the

honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as *Hudson Trust Co. v. American Linseed Co.,* 232 N.Y. 350, 134 N.E. 178 (1922), *and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.,* 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security certificate"	Section 8-102(a)(14).
"Unauthorized signature"	Section 1-201(43).

§ 25-8-206. Completion of alteration of security certificate.

(a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) Any person may complete it by filling in the blanks as authorized; and

(2) Even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms. (1899, c. 733, ss. 14, 15, 124; Rev., ss. 2164, 2165, 2274; C.S., ss. 2995, 2996, 3106; 1941, c. 353, s. 16; G.S., s. 55-96; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a)).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210).

Definitional Cross References:

"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security certificate"	Section 8-102(a)(16).
"Unauthorized signature"	Section 1-201(43).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-207. Rights and duties of issuer with respect to registered owners.

(a) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(b) This Article does not affect the liability of the registered owner of a security for a call, assessment, or the like. (1941, c. 353, s. 3; G.S., s. 55-83; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsections (a) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporations,* 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See *State ex rel. Squire v. Murfey, Blosson & Co.,* 131 Ohio St. 289, 2 N.E.2d 866 (1936); *Willing v. Delaplaine,* 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Registered form"	Section 8-102(a)(13).
"Security"	Section 8-102(a)(15).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-208. Effect of signature of authenticating trustee, registrar, or transfer agent.

(a) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) The certificate is genuine;

(2) The person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) The person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under subsection (a) of this section does not assume responsibility for the validity of the security in other respects. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefor been made explicit in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.,* 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co.,* 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co.,* 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York,* 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act, (U.S.C.A. Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefor held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co.,* supra; *Mullen v. Eastern Trust & Banking Co.,* 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Genuine"	Section 1-201(18).
"Issuer"	Section 8-201.
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-209. Issuer's lien.

A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate. (1997-181, s. 1.)

OFFICIAL COMMENT

This section is similar to Sections 8-202 and 8-204 which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement in haec verba. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204, see Comment 2 to Section 8-202.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-210. Overissue.

(a) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in subsections (c) and (d) of this section, the provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, *McWilliams v. Geddes & Moss Undertaking Co.,* 169 So. 894 (1936, La.); *Crawford v. Twin City Oil Co.,* 216 Ala. 216, 113 So. 61 (1927); *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefor, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d). The last clause of subsection (a), which is added in Revised Article 8, does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co.,* 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). The measure of such damages, however, has been open to

question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston Railroad, 150 Mass.* 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); *Commercial Bank v. Kortright,* 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References:

"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

PART 3.

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES.

§ 25-8-301. Delivery.

(a) Delivery of a certificated security to a purchaser occurs when:

(1) The purchaser acquires possession of the security certificate;

(2) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser. (1899, c. 733, ss. 52, 57 to 59; Rev., ss. 2201, 2206 to 2208; C.S., ss. 3033, 3038 to 3040; 1941, c. 353, ss. 6, 7; G.S., ss. 55-86, 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1; 2000-169, s. 24.)

AMENDED OFFICIAL COMMENT (1999 ED.)

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transactions, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires

a security entitlement, rather than having a direct interest. See Section 8-501. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer. Note that delivery is a method of perfecting a security interest in a certified security. See Section 9-313(a), (e).

3. Subsection (b) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called "delivery," as in the expression "delivery versus payment." The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2).

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Effective"	Section 8-107.
"Issuer"	Section 8-201.
"Purchaser"	Sections 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).
"Special indorsement"	Section 8-304(a).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-302. Rights of purchaser.

(a) Except as otherwise provided in subsections (b) and (c) of this section, a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser. (1899, c. 733, s. 52; Rev., s. 2201; C.S., s. 3033; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1; 2000-169, s. 25.)

AMENDED OFFICIAL COMMENT (1999 ED.)

1. Subsection (a) provides that a purchaser of a certificated or uncertificated security acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security, it does not state that a person can acquire an interest in a security only by purchase. Article 8 also is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Delivery"	Section 8-301.
"Notice of adverse claim"	Section 8-105.

"Protected purchaser"	Section 8-303.
"Purchaser"	Sections 1-201(33) & 8-116.
"Uncertificated security"	Section 8-102(a)(18).

Editor's Note. — The comments in this section contain technical amendments approved through July, 2000.

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

§ 25-8-303. Protected purchaser.

(a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) Gives value;

(2) Does not have notice of any adverse claim to the security; and

(3) Obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim. (1965, c. 700, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in section 1-201. A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44). See also Section 8-116 (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1). Section 8-105 specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d).

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202.

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b), plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b). Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404, unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406.

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2). The control agreement device of Section 8-106(c)(2) takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse

claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Certificated security"	Section 8-102(a)(4).
"Control"	Section 8-106.
"Notice of adverse claim"	Section 8-105.
"Purchaser"	Sections 1-201(33) & 8-116.
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-304. Indorsement.

(a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in G.S. 25-8-108 and not an obligation that the security will be honored by the issuer. (1899, c. 733, ss. 37, 56; Rev., ss. 2186, 2205; C.S., ss. 3018, 3037; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. By virtue of the definition of indorsement in Section 8-102 and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears in the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. *Levey v. Nason,* 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America,* 237 App.Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of

contracts, and this article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection (d) on right to compel indorsement, such as is envisaged in *Johnson v. Johnson,* 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) deals with the effect of delivery without indorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See *Coats v. Guaranty Bank & Trust Co.,* 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108).

Definitional Cross References:

"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Indorsement"	Section 8-102(a)(11).
"Purchaser"	Sections 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Security certificate"	Section 8-102(a)(16).

CASE NOTES

Cited in In re Estate of Washburn, 158 N.C. App. 457, 581 S.E.2d 148, 2003 N.C. App. LEXIS 1148 (2003).

§ 25-8-305. Instruction.

(a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by G.S. 25-8-108 and not an obligation that the security will be honored by the issuer. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The term instruction is defined in Section 8-102(a)(12) as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6). Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 and its comment, dealing with blanks left upon issue.

2. Subsection (b) makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.

§ 25-8-306. Effect of guaranteeing signature, indorsement, or instruction.

(a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) The signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) The signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (b) of this section and also warrants that at the time the instruction is presented to the issuer:

(1) The person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) The transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(d) A guarantor under subsections (a) and (b) of this section or a special guarantor under subsection (c) of this section does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (a) of this section and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (c) of this section and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor. (1899, c. 733, ss. 65 to 67, 69; Rev., ss. 2214 to 2216, 2218; C.S., ss. 3046 to 3048, 3050; 1941, c. 353, ss. 11, 12; G.S., ss. 55-91, 55-92; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) to include a successor or person who has power under other law to act for a person who is deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of *Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.,* 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) of subsection (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under paragraph (2), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered owner-

ship and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser, or indorsed in blank. By specially guaranteeing under subsection (c), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) makes clear what can be inferred from the combination of Sections 8-401 and 8-402, that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-307. Purchaser's right to requisites for registration of transfer.

Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer. (1899, c. 733, s. 49; Rev., s. 2198; C.S., s. 3030; 1941, c. 353, s. 9; G.S., s. 55-89; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps, and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare Section 8-304(d). If a transfer is not for value the transferee need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional Cross References:

"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Value"	Sections 1-201(44) & 8-116.

PART 4.

REGISTRATION.

§ 25-8-401. Duty of issuer to register transfer.

(a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) Under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) The indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) Reasonable assurance is given that the indorsement or instruction is genuine and authorized (G.S. 25-8-402);

(4) Any applicable law relating to the collection of taxes has been complied with;

(5) The transfer does not violate any restriction on transfer imposed by the issuer in accordance with G.S. 25-8-204;

(6) A demand that the issuer not register transfer has not become effective under G.S. 25-8-403, or the issuer has complied with G.S. 25-8-403(b) but no legal process or indemnity bond is obtained as provided in G.S. 25-8-403(d); and

(7) The transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404.

2. By subsection (b) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this part similar to those of the issuer. See Section 8-407.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Certificated security"	Section 8-102(a)(4).
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Protected purchaser"	Section 8-303.
"Registered form"	Section 8-102(a)(13).
"Uncertificated security"	Section 8-102(a)(18).

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

§ 25-8-402. Assurance that indorsement or instruction is effective.

(a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) In all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) If the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) If the indorsement is made or the instruction is originated by a fiduciary pursuant to G.S. 25-8-107(a)(4) or G.S. 25-8-107(a)(5), appropriate evidence of appointment or incumbency;

(4) If there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) If the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(2) "Appropriate evidence of appointment or incumbency" means:

(i) In the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within 60 days before the date of presentation for transfer; or

(ii) In any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considers appropriate. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b).

2. Under subsection (a)(1), the issuer may require in all cases a guaranty of signature. See Section 8-306. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) allows the issuer to require that the person making these guaranties be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 C.F.R. 240.17Ad-15.

3. This section, by paragraphs (2) through (5) of subsection (a), permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c). Hence court orders and other controlling instruments are omitted from subsection (a).

Subsection (a)(3) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i). Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d), hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) to require assurance beyond that specified in subsection (a). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.

§ 25-8-403. Demand that issuer not register transfer.

(a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) The certificated security has been presented for registration of transfer or the instruction for registration of transfer of the uncertificated security has been received;

(2) A demand that the issuer not register transfer had previously been received; and

(3) The issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in subdivision (b)(3) of this section may not exceed 30 days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) Obtain an appropriate restraining order, injunction, or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) File with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective. (1965, c. 700, s. 1; 1977, c. 814, s. 9; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(d); 1997-181, s. 1.)

OFFICIAL COMMENT

1. The general rule under this article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404. Section 8-403 is an exception to this general rule. It permits the registered owner — but not third parties — to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See Section 8-406. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406, might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Certificated security"	Section 8-102(a)(4).
"Communicate"	Section 8-102(a)(6).
"Effective"	Section 8-107.
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Registered form"	Section 8-102(a)(13).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-404. Wrongful registration.

(a) Except as otherwise provided in G.S. 25-8-406, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(1) Pursuant to an ineffective indorsement or instruction;
(2) After a demand that the issuer not register transfer became effective under G.S. 25-8-403(a) and the issuer did not comply with G.S. 25-8-403(b);
(3) After the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or
(4) By an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under subsection (a) of this section on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by G.S. 25-8-210.

(c) Except as otherwise provided in subsection (a) of this section or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a)(1) provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.,* 159 Wis. 517, 149 N.W. 754 (1914). Article 8 does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (a) and (c) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective indorsement or instruction, if the issuer had in

some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 (1978).

The rule of former Section 8-403 was anomalous inasmuch as Section 8-207 provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See *Kerrigan v. American Orthodontics Corp.*, 960 F.2d 43 (7th Cir. 1992). The change made in the present version of Section 8-404 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Effective"	Section 8-107.
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-405. Replacement of lost, destroyed, or wrongfully taken security certificate.

(a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed, or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) So requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) Files with the issuer a sufficient indemnity bond; and

(3) Satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by G.S. 25-8-210. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser. (1941, c. 353, s. 20; G.S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section enables the owner to obtain a replacement of a lost, destroyed, or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner — who was in the best position to prevent the loss, destruction or theft of the security certificate — is now deprived of the new security certificate issued as a replacement. This changes the pre-Uniform Commercial Code law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. *Keller v. Eureka Brick Mach. Mfg. Co.*, 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References:

"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Notice"	Section 1-201(25).
"Overissue"	Section 8-210.
"Protected purchaser"	Section 8-303.
"Registered form"	Section 8-102(a)(13).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-406. Obligation to notify issuer of lost, destroyed, or wrongfully taken security certificate.

If a security certificate has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under G.S. 25-8-404 or a claim to a new security certificate under G.S. 25-8-405. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404, unless the owner made an effective demand that the issuer not register transfer under Section 8-403.

Definitional Cross References:

"Issuer"	Section 8-201.
"Notify"	Section 1-201(25).
"Security certificate"	Section 8-102(a)(16).

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

§ 25-8-407. Authenticating trustee, transfer agent, and registrar.

A person acting as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions. (1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefor refused to recognize their liability to the owner for mere nonfeasance, i.e., refusal to register a transfer, are rejected. *Hulse v. Consolidated Quicksilver Mining Corp.,* 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan,* 119 Misc. 309, 196 N.Y.Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co.,* 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405, which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. *Switzerland General Ins. Co. of Zurich v. N.Y.C. & H.R.R. Co.,* 152 App.Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).

"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

Editor's Note. — A former G.S. 25-8-407 was repealed by Session Laws 1969, c. 1115, s. 1, effective at midnight, June 30, 1969.

PART 5

SECURITY ENTITLEMENTS.

§ 25-8-501. Securities account; acquisition of security entitlement from securities intermediary.

(a) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e) of this section, a person acquires a security entitlement if a securities intermediary:

(1) Indicates by book entry that a financial asset has been credited to the person's securities account;

(2) Receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) Becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) of this section has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Part 5 rules apply to security entitlements, and Section 8-501(b) provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3). There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102, however, states the fundamental principle of interpretation that the Code provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5, which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) of this section specifies what circumstances give rise to security entitlements. Paragraph (1) of subsection (b) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph (1) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) of subsection (b) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) will also be covered by paragraph (1), because the intermediary will have credited the positions to the customer's account.

Paragraph (3) of subsection (b) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) test, the paragraph (3) test would not be needed for the ordinary cases, since they are covered by paragraph (1).

3. In a sense, Section 8-501(b) is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) is intended to make this point clear. Subsection (c) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 and regulatory law. Subsection (c) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15). If so, then by virtue of subsection (e) of Section 8-501, the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities.

The subsection (e) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of the definition of security in Section 8-102(a)(15) are the "transferability" and "divisibility" tests. Securities, in the Article 8 sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that he or she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References:

"Financial asset"	Section 8-102(a)(9).
"Indorsement"	Section 8-102(a)(11).
"Securities intermediary"	Section 8-102(a)(14).
"Security"	Section 8-102(a)(15).
"Security entitlement"	Section 8-102(a)(17).

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Legal Periodicals. — For 1997 legislative survey, see 20 Campbell L. Rev. 401.

§ 25-8-502. Assertion of adverse claim against entitlement holder.

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under G.S. 25-8-501 for value and without notice of the adverse claim. (1997-181, s. 1.)

AMENDED OFFICIAL COMMENT (1999 ED.)

Editor's Note. *— This Amended Official Comments accompanies the revision to Article 9, effective July 1, 2001.*

1. This section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (Section 8-303).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of the indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares." Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property in favor of S. See G. Palmer, The Law of Restitution G.S. 2.14. Section 8-502 ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See section 8-507(b).

3. The following examples illustrate the operation of Section 8-502.

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44). If Creditor did not have notice of Owner's claim, Section 8-502 precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume — implausibly — that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-312. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume — implausibly — that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501. Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt. See Section 1-201(44). If Lending Bank did not have notice of Acme's claim, Section 8-502 will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

Example 6. Debtor grants Alpha Co. a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha's account. Alpha has control of the 1000 shares under Section 8-106(d). (The facts to this point are identical to those in Section 8-106, Comment 4, Example 1, except that Alpha Co. was Alpha Bank.) Alpha next grants Beta Co. a security interest in the 1000 shares included in Alpha's security entitlement. See Section 9-207(c)(3). Alpha instructs Able to transfer the shares to Gamma Co., Beta's custodian. Able does so, and Gamma credits the 1000 shares to Beta's account. Beta now has control under section 8-106(d). By virtue of Debtor's explicit permission or by virtue of the permission inherent in Debtor's creation of a security interest in favor of Alpha and Alpha's resulting power to grant a security interest under Section 9-207, Debtor has no adverse claim to assert against Beta, assuming implausibly that Debtor could "trace" an interest to the Gamma account. Moreover, even if Debtor did hold an adverse claim, if Beta did not have notice of Debtor's claim, Section 8-502 will preclude any action by Debtor against Beta, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b). Section 8-502 protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Financial asset"	Section 8-102(a)(9).
"Notice of adverse claim"	Section 8-105.

"Security entitlement"	Section 8-102(a)(17).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-503. Property interest of entitlement holder in financial asset held by securities intermediary.

(a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in G.S. 25-8-511.

(b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under G.S. 25-8-505 through G.S. 25-8-508.

(d) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against a purchaser of the financial asset or interest therein only if:

(1) Insolvency proceedings have been initiated by or against the securities intermediary;
(2) The securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;
(3) The securities intermediary violated its obligations under G.S. 25-8-504 by transferring the financial asset or interest therein to the purchaser; and
(4) The purchaser is not protected under subsection (e) of this section.

The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under G.S. 25-8-504. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) provides that to the extent necessary to satisfy all

customer claims, all units of that security held by the firm are held for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511.

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) makes clear that the property interest described in subsection (a) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and the Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts. The traditional Article 8 rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) reflect these fundamental principles.

Subsection (c) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection (d) provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504. Thus, paragraphs (1), (2), and (3) of subsection (d) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e), unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 also contains general adverse claim cut-off rules for the indirect holding system. See Sections 8-502 and 8-510. The rule of subsections (d) and (e) takes precedence over the general cut-off rules of those sections, because Section 8-503 itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e), rather than by the "without notice" test of Sections 8-502 and 8-510.

3. The limitations that subsections (c) through (e) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the *post hoc* perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 concerning transfers by fiduciaries provide a good example. Under *Lowry v. Commercial & Farmers' Bank,* 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the *Lowry* rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8, and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511. The statement in subsection (a) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the debtor must have "rights" in the collateral, see Section 9-203, the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511, which is an application to secured transactions of the general principles expressed in subsections (d) and (e) of this section.

Definitional Cross References:

"Control"	Section 8-106.
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Insolvency proceedings"	Section 1-201(22).
"Purchaser"	Sections 1-201(33) & 8-116.
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-504. Duty of securities intermediary to maintain financial asset.

(a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a) of this section.

(c) A securities intermediary satisfies the duty in subsection (a) of this section if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. G.S. 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom an securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511.

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 contains an "agreement/due care" provision. Second, Section 8-509 sets out general qualifications on the duties stated in these sections, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 duties.

4. The "agreement/due care" provision in subsection (c) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the

risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) provides that a securities intermediary satisfies the duty stated in subsection (a) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1), compliance with the agreement constitutes satisfaction of the subsection (a) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10), would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) has specified the details of the intermediary's performance of the subsection (a) duty, subsection (c)(2) provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safeguarding of customer securities. See 17 C.F.R. 240.15c3-3. Section 8-509(a) provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-503. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e). Accordingly, the general duty of an intermediary under subsection (a) does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Clearing corporation"	Section 8-102(a)(5).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-505. Duty of securities intermediary with respect to payments and distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary. (1997-181, s. 1.)

OFFICIAL COMMENT

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of part 5 dealing with the duties of a securities intermediary. See comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off, counterclaim, or the like. Section 8-509(c) makes this point explicit.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-506. Duty of securities intermediary to exercise rights as directed by entitlement holder.

A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or

exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 also applies to the Section 8-506 duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a), compliance with such regulatory requirement constitutes compliance with the Section 8-506 duty.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-507. Duty of securities intermediary to comply with entitlement order.

(a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) of this section states another aspect of duties of securities intermediaries that make up security entitlements — the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) states the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 apply to the Section 8-507 duty.

3. Appropriate person is defined in Section 8-107. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3). Entitlement holder is defined in Section 8-102(a)(7) as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5), which provide that the term "appropriate person" includes the successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b). Moreover, Section 8-507(a) provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b), together with Section 8-107, has the effect of leaving to other law most of the questions of the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 is not a codification of all of the law of customers and stockbrokers. Article 8 deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this article.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Appropriate person"	Section 8-107.
"Effective"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-508. Duty of securities intermediary to change entitlement holder's position to other form of security holding.

A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements — the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in blank or specially indorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 apply to the Section 8-508 duty.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-509. Specification of duties of securities intermediary by other statute or regulation; manner of performance of duties of securities intermediary and exercise of rights of entitlement holder.

(a) If the substance of a duty imposed upon a securities intermediary by G.S. 25-8-504 through G.S. 25-8-508 is the subject of other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by G.S. 25-8-504 through G.S. 25-8-508 is subject to:

(1) Rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) Rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) G.S. 25-8-504 through G.S. 25-8-508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule. (1997-181, s. 1.)

OFFICIAL COMMENT

This article is not a comprehensive statement of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Securities intermediary"	Section 8-102(a)(14).
"Security agreement"	Section 9-105(1)(l).
"Security interest"	Section 1-201(37).

§ 25-8-510. Rights of purchaser of security entitlement from entitlement holder.

(a) In a case not covered by the priority rules in Article 9 of this Chapter or the rules stated in subsection (c) of this section, an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under G.S. 25-8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Article 9 of this Chapter, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (d) of this section, purchasers who have control rank according to priority in time of:

(1) The purchaser's becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under G.S. 25-8-106(d)(1);

(2) The securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under G.S. 25-8-106(d)(2); or

(3) If the purchaser obtained control through another person under G.S. 25-8-106(d)(3), the time on which priority would be based under this subsection if the other person were the secured party.

(d) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary. (1997-181, s. 1; 2000-169, s. 26.)

AMENDED OFFICIAL COMMENT (1999 ED.)

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants Bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501. Under other law, Owner may be able have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

> *Example 3.* Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(33), it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 rule. Thus, by virtue of the Section 8-510(b), Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

> *Example 4.* Dealer holds securities through an account at Alpha Bank. Alpha Bank in turn holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section 9-328(1). The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default temporal priority rule for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-328(2) and Comment 5 to Section 9-328. Because the purchaser priority rule in Section 8-510(c) is intended to track the Article 9 priority rules, it too has a temporal priority rule for cases where multiple nonsecured party purchasers have obtained control but omitted to specify their respective rights by agreement. The rule is patterned on Section 9-328(2).

5. If a securities intermediary itself is a purchaser, subsection (d) provides that it has priority over the interest of another purchaser who has control. Article 9 contains a similar rule. See Section 9-328(3).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Control"	Section 8-106.
"Entitlement holder"	Section 8-102(a)(7).
"Notice of adverse claim"	Section 8-105.
"Purchase"	Section 1-201(32).
"Purchaser"	Sections 1-201(33) & 8-116.
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-511. Priority among security interests and entitlement holders.

(a) Except as otherwise provided in subsections (b) and (c) of this section, if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) provides that entitlement holders' claims have priority except as otherwise provided in subsection (b), and subsection (b) provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c), but Alpha Bank did not obtain control under Section 8-106. Thus, under Section 8-511(a) the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 and 9-115. Under Section 8-511(b), Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503, and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e), the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 mirrors that requirement, specifying in Section 8-504 that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its customers are protected against loss from a shortfall by the federal Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsection (c) provides a priority for secured lenders to such clearing corporations. Subsection (c) does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References:

"Clearing corporation"	Section 8-102(a)(5).
"Control"	Section 8-106.
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Security interest"	Section 1-201(37).
"Value"	Sections 1-201(44) & 8-116.

TABLES OF COMPARABLE SECTIONS FOR CHAPTER 25, REVISED ARTICLE 8

Former to Present

Editor's Note. — The following table shows G.S. sections from former Chapter 25, Article 8, and their comparable, new revised Chapter 25, Article 8 numbers. Where there is no comparable new number, the term "Omitted" has been inserted.

Former Section	Present Section
25-8-101	25-8-101
25-8-102(1)(a)	25-8-102(a)(4) and (15)
25-8-102(1)(b)	25-8-102(a)(15) and (18)
25-8-102(1)(c)	25-8-102(a)(15)
25-8-102(1)(d)	25-8-102(a)(13)
25-8-102(1)(e)	25-8-102(a)(2)
25-8-102(2)	25-8-202(b)(1)
25-8-102(3)	25-8-102(a)(5)
25-8-1-2(4)	Omitted
25-8-102(5)	25-8-102(b)
25-8-102(6)	25-8-102(c)
25-8-103	25-8-209
25-8-104	25-8-210
25-8-105(1)	Omitted
25-8-105(2)	Omitted
25-8-105(3)	25-8-114
25-8-106	25-8-110
25-8-107	Omitted
25-8-108	Omitted
25-8-201	25-8-201
25-8-202	25-8-202
25-8-203	25-8-203
25-8-204	25-8-204
25-8-205	25-8-205
25-8-206	25-8-206
25-8-207	25-8-207
25-8-208	25-8-208
25-8-301	25-8-302(a) and (b)
25-8-302(1)	25-8-303(a)
25-8-302(2)	25-8-102(a)(1)
25-8-302(3)	25-8-303(b)
25-8-302(4)	25-8-302(c)
25-8-303	25-8-102(a)(3)
25-8-304(1)	25-8-105(d)
25-8-304(2)	Omitted
25-8-304(3)	25-8-105(b)
25-8-305	25-8-105(c)
25-8-306(1)	25-8-108(f)
25-8-306(2)	25-8-108(a)
25-8-306(3)	25-8-108(g)
25-8-306(4)	25-8-108(h)
25-8-306(5)	25-8-108(e)
25-8-306(6)	25-8-306(h)
25-8-306(7)	25-8-108(b), 25-8-306(h)
25-8-306(8)	Omitted
25-8-306(9)	25-8-108(c)
25-8-306(10)	25-8-108(i)
25-8-307	25-8-304(d)
25-8-308(1)	25-8-102(a)(11), 25-8-107
25-8-308(2)	25-8-304(a)
25-8-308(3)	25-8-304(b)
25-8-308(4)	25-8-102(a)(12)
25-8-308(5)	25-8-107, 25-8-305(a)
25-8-308(6)	25-8-107
25-8-308(7)	25-8-107
25-8-308(8)	25-8-107
25-8-308(9)	25-8-304(f), 25-8-305(b)
25-8-308(10)	25-8-107
25-8-308(11)	25-8-107
25-8-309	25-8-304(c)
25-8-310	25-8-304(e)
25-8-311(a)	Omitted, see 25-8-106(b)(2), 25-8-301(b)(1), 25-8-303
25-8-311(b)	25-8-404
25-8-312	25-8-306
25-8-313(1)(a)	Omitted, see 25-8-301(a)(1) and (2)
25-8-313(1)(b)	Omitted, see 25-8-301(b)(1) and (2)
25-8-313(1)(c)	Omitted, see 25-8-301(a)(3)
25-8-313(1)(d)	Omitted, see 25-8-501(b)
25-8-313(1)(e)	Omitted, see 25-8-301(a)(2)
25-8-313(1)(f)	Omitted, see 25-8-301(b)(2)
25-8-313(1)(g)	Omitted, see 25-8-501(b), 25-8-111
25-8-313(1)(h)-(j)	Omitted, see 25-9-115, 25-9-203
25-8-313(2)	Omitted, see 25-8-503
25-8-313(3)	Omitted
25-8-313(4)	25-8-102(a)(14)
25-8-314	Omitted
25-8-315	Omitted
25-8-316	25-8-307
25-8-317	25-8-112
25-8-318	25-8-115
25-8-319	Omitted, see 25-8-113
25-8-320	Omitted
25-8-321	Omitted, see 25-9-115, 25-9-203
25-8-401	25-8-401
25-8-402	25-8-402
25-8-403	25-8-403
25-8-404	25-8-404
25-8-405(1)	25-8-406

Former Section	Present Section
25-8-405(2)	25-8-405(a)
25-8-405(3)	25-8-405(b)
25-8-406	25-8-407
25-8-407	Omitted
25-8-408	Omitted

ARTICLE 9.

Secured Transactions.

(Revised)

Editor's Note. — Session Laws 2000-169, s. 1, effective July 1, 2001, rewrote Article 9 of Chapter 25 of the Uniform Commercial Code. At the end of Article 9 are tables showing comparable sections and their disposition in new Article 9. This revised Article 9 supersedes the revision of Article 9 by Session Laws 1975, c. 862, s. 1. Where appropriate, historical citations to sections of former Article 9 have been placed under corresponding sections of revised Article 9.

Session Laws 2001-218, s. 6, provides: "The Revisor of Statutes shall cause to be printed along with the portions of this act amending Article 9 of Chapter 25 of the General Statutes, such North Carolina official comments explaining the amendments made by this act as the Revisor deems appropriate."

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PART 1.

GENERAL PROVISIONS.

Subpart 1. Short Title, Definitions, and General Concepts.

§ 25-9-101. Short title.

This Article may be cited as Uniform Commercial Code-Secured Transactions. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

Editor's Note. *— The Amended Official Comment (2001 Edition) is set out below to correct the Official Comment appearing in the main volume.*

1. **Source.** This article supersedes former Uniform Commercial Code (UCC) article 9. As did its predecessor, it provides a comprehensive scheme for the regulation of security interests in personal property and fixtures. For the most part this article follows the general approach and retains much of the terminology of former article 9. In addition to describing many aspects of the operation and interpretation of this article, these comments explain the material changes that this article makes to former article 9. Former article 9 superseded the wide variety of pre-UCC security devices. Unlike the comments to former article 9, however, these comments dwell very little on the pre-UCC state of the law. For that reason, the comments to former article 9 will remain of substantial historical value and interest. They also will remain useful in understanding the background and general conceptual approach of this article.

Citations to "Bankruptcy Code section ________ " in these comments are to Title 11 of the United States Code as in effect on December 31, 1998.

2. **Background and History.** In 1990, the Permanent Editorial Board for the UCC with the support of its sponsors, The American Law Institute and the National Conference of Commissioners on Uniform State Laws, established a committee to study article 9 of the UCC. The study committee issued its report as of December 1, 1992, recommending the creation of a drafting committee for the revision of article 9 and also recommending numerous specific changes to article 9. Organized in 1993, a drafting committee met fifteen times from 1993 to 1998. This article was approved by its sponsors in 1998.

3. **Reorganization and Renumbering;**

Captions; Style. This article reflects a substantial reorganization of former article 9 and renumbering of most sections. New part 4 deals with several aspects of third-party rights and duties that are unrelated to perfection and priority. Some of these were covered by part 3 of former article 9. Part 5 deals with filing (covered by former part 4) and part 6 deals with default and enforcement (covered by former part 5). Appendix I contains conforming revisions to other articles of the UCC, and Appendix II contains model provisions for production-money priority.

This article also includes headings for the subsections as an aid to readers. Unlike section captions, which are part of the UCC, see section 1-109, subsection headings are not a part of the official text itself and have not been approved by the sponsors. Each jurisdiction in which this article is introduced may consider whether to adopt the headings as a part of the statute and whether to adopt a provision clarifying the effect, if any, to be given to the headings. This article also has been conformed to current style conventions.

4. **Summary of Revisions.** Following is a brief summary of some of the more significant revisions of article 9 that are included in this article.

a. **Scope of Article 9.** This article expands the scope of article 9 in several respects.

Deposit accounts. Section 9-109 includes within this article's scope deposit accounts as original collateral, except in consumer transactions. Former article 9 dealt with deposit accounts only as proceeds of other collateral.

Sales of payment intangibles and promissory notes. Section 9-109 also includes within the scope of this article most sales of "payment intangibles" (defined in section 9-102 as general intangibles under which an account debtor's principal obligation is monetary) and "promissory notes" (also defined in section 9-102). Former article 9 included sales of accounts and chattel paper, but not sales of payment intangibles or promissory notes. In its inclusion of sales of payment intangibles and promissory notes, this article continues the drafting convention found in former article 9; it provides that the sale of accounts, chattel paper, payment intangibles, or promissory notes creates a "security interest." The definition of "account" in section 9-102 also has been expanded to include various rights to payment that were general intangibles under former article 9.

Health-care-insurance receivables. Section 9-109 narrows article 9's exclusion of transfers of interests in insurance policies by carving out of the exclusion "health-care-insurance receivables" (defined in section 9-102). A health-care-insurance receivable is included within the definition of "account" in section 9-102.

Nonpossessory statutory agricultural liens. Section 9-109 also brings nonpossessory statutory agricultural liens within the scope of article 9.

Consignments. Section 9-109 provides that "true" consignments—bailments for the purpose of sale by the bailee—are security interests covered by article 9, with certain exceptions. See section 9-102 (defining "consignment"). Currently, many consignments are subject to article 9's filing requirements by operation of former section 2-326.

Supporting obligations and property securing rights to payment. This article also addresses explicitly (i) obligations, such as guaranties and letters of credit, that support payment or performance of collateral such as accounts, chattel paper, and payment intangibles, and (ii) any property (including real property) that secures a right to payment or performance that is subject to an article 9 security interest. See sections 9-203, 9-308.

Commercial tort claims. Section 9-109 expands the scope of article 9 to include the assignment of commercial tort claims by narrowing the exclusion of tort claims generally. However, this article continues to exclude tort claims for bodily injury and other nonbusiness tort claims of a natural person. See section 9-102 (defining "commercial tort claim").

Transfers by states and governmental units of states. Section 9-109 narrows the exclusion of transfers by states and their governmental units. It excludes only transfers covered by another statute (other than a statute generally applicable to security interests) to the extent the statute governs the creation, perfection, priority, or enforcement of security interests.

Nonassignable general intangibles, promissory notes, health-care-insurance receivables, and letter-of-credit rights. This article enables a security interest to attach to letter-of-credit rights, health-care-insurance receivables, promissory notes, and general intangibles, including contracts, permits, licenses, and franchises, notwithstanding a contractual or statutory prohibition against or limitation on assignment. This article explicitly protects third parties against any adverse effect of the creation or attempted enforcement of the security interest. See sections 9-408 and 9-409.

Subject to sections 9-408 and 9-409 and two other exceptions (sections 9-406, concerning accounts, chattel paper, and payment intangibles, and 9-407, concerning interests in leased goods), section 9-401 establishes a baseline rule that the inclusion of transactions and collateral within the scope of article 9 has no effect on nonarticle 9 law dealing with the alienability or inalienability of property. For example, if a commercial tort claim is nonassignable under other applicable law, the fact that a security interest in the claim is within the scope of article 9 does not override the other applicable law's effective prohibition of assignment.

b. **Duties of Secured Party.** This article provides for expanded duties of secured parties.

Release of control. Section 9-208 imposes upon a secured party having control of a deposit account, investment property, or a letter-of-credit right the duty to release control when there is no secured obligation and no commitment to give value. Section 9-209 contains analogous provisions when an account debtor has been notified to pay a secured party.

Information. Section 9-210 expands a secured party's duties to provide the debtor with information concerning collateral and the obligations that it secures.

Default and enforcement. Part 6 also includes some additional duties of secured parties in connection with default and enforcement. See, e.g., section 9-616 (duty to explain calculation of deficiency or surplus in a consumer-goods transaction).

c. **Choice of Law.** The choice of law rules for the law governing perfection, the effect of perfection or nonperfection, and priority are found in part 3, subpart 1 (sections 9-301 through 9-307). See also section 9-316.

Where to file: Location of debtor. This article changes the choice of law rule governing perfection (i.e., where to file) for most collateral to the law of the jurisdiction where the debtor is located. See section 9-301. Under former article 9, the jurisdiction of the debtor's location governed only perfection and priority of a security interest in accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property.

Determining debtor's location. As a baseline rule, section 9-307 follows former section 9-103, under which the location of the debtor is the debtor's place of business (or chief executive office, if the debtor has more than one place of business). Section 9-307 contains three major exceptions. First, a "registered organization," such as a corporation or limited liability company, is located in the state under whose law the debtor is organized, e.g., a corporate debtor's state of incorporation. Second, an individual debtor is located at his or her principal residence. Third, there are special rules for determining the location of the United States and registered organizations organized under the law of the United States.

Location of non-U.S. debtors. If, applying the foregoing rules, a debtor is located in a jurisdiction whose law does not require public notice as a condition of perfection of a nonpossessory security interest, the entity is deemed located in the District of Columbia. See section 9-307. Thus, to the extent that this article applies to non-U.S. debtors, perfection could be accomplished in many cases by a domestic filing.

Priority. For tangible collateral such as goods and instruments, section 9-301 provides that the law applicable to priority and the effect of perfection or nonperfection will remain the law of the jurisdiction where the collateral is located, as under former section 9-103 (but without the confusing "last event" test). For intangible collateral, such as accounts, the applicable law for priority will be that of the jurisdiction in which the debtor is located.

Possessory security interests; agricultural liens. Perfection, the effect of perfection or nonperfection, and priority of a possessory security interest or an agricultural lien are governed by the law of the jurisdiction where the collateral subject to the security interest or lien is located. See sections 9-301 and 9-302.

Goods covered by certificates of title; deposit accounts; letter-of-credit rights; investment property. This article includes several refinements to the treatment of choice of law matters for goods covered by certificates of title. See section 9-303. It also provides special choice of law rules, similar to those for investment property under current articles 8 and 9, for deposit accounts (section 9-304), investment property (section 9-305), and letter-of-credit rights (section 9-306).

Change in applicable law. Section 9-316 addresses perfection following a change in applicable law.

d. **Perfection.** The rules governing perfection of security interests and agricultural liens are found in part 3, subpart 2 (sections 9-308 through 9-316).

Deposit accounts; letter-of-credit rights. With certain exceptions, this article provides that a security interest in a deposit account or a letter-of-credit right may be perfected only by the secured party's acquiring "control" of the deposit account or letter-of-credit right. See sections 9-312 and 9-314. Under section 9-104, a secured party has "control" of a deposit account when, with the consent of the debtor, the secured party obtains the depositary bank's agreement to act on the secured party's instructions (including when the secured party becomes the account holder) or when the secured party is itself the depositary bank. The control requirements are patterned on section 8-106, which specifies the requirements for control of investment property. Under section 9-107, "control" of a letter-of-credit right occurs when the issuer or nominated person consents to an assignment of proceeds under section 5-114.

Electronic chattel paper. Section 9-102 includes a new defined term: "Electronic chattel paper." Electronic chattel paper is a record or records consisting of information stored in an electronic medium (i.e., it is not written). Perfection of a security interest in electronic chattel paper may be by control or filing. See sections 9-105 (sui generis definition of control of electronic chattel paper), 9-312 (perfection by filing), and 9-314 (perfection by control).

Investment property. The perfection requirements for "investment property" (defined in section 9-102), including perfection by control under section 9-106, remain substantially unchanged. However, a new provision in section 9-314 is designed to ensure that a secured party retains control in "repledge" transactions that are typical in the securities markets.

Instruments, agricultural liens, and commercial tort claims. This article expands the types of collateral in which a security interest may be perfected by filing to include instruments. See section 9-312. Agricultural liens and security interests in commercial tort claims also are perfected by filing, under this article. See sections 9-308 and 9-310.

Sales of payment intangibles and promissory notes. Although former article 9 covered the outright sale of accounts and chattel paper, sales of most other types of receivables also are financing transactions to which article 9 should apply. Accordingly, section 9-102 expands the definition of "account" to include many types of receivables (including "health-care-insurance receivables," defined in section 9-102) that former article 9 classified as "general intangibles." It thereby subjects to article 9's filing system sales of more types of receivables than did former article 9. Certain sales of payment intangibles—primarily bank loan participation transactions—should not be subject to the article 9 filing rules. These transactions fall in a residual category of collateral, "payment intangibles" (general intangibles under which the account debtor's principal obligation is monetary), the sale of which is exempt from the filing requirements of article 9. See sections 9-102, 9-109, and 9-309 (perfection upon attachment). The perfection rules for sales of promissory notes are the same as those for sales of payment intangibles.

Possessory security interests. Several provisions of this article address aspects of security interests involving a secured party or a third party who is in possession of the collateral. In particular, section 9-313 resolves a number of uncertainties under former section 9-305. It provides that a security interest in collateral in the possession of a third party is perfected when the third party acknowledges in an authenticated record that it holds for the secured party's benefit. Section 9-313 also provides that a third party need not so acknowledge and that its acknowledgment does not impose any duties on it, unless it otherwise agrees. A special rule in section 9-313 provides that if a secured party already is in possession of collateral, its security interest remains perfected by possession if it delivers the collateral to a third party and the collateral is accompanied by instructions to hold it for the secured party or to redeliver it to the secured party. Section 9-313 also clarifies the limited circumstances under which a security interest in goods covered by a certificate of title may be perfected by the secured party's taking possession.

Automatic perfection. Section 9-309 lists various types of security interests as to which no public-notice step is required for perfection (e.g., purchase-money security interests in consumer goods other than automobiles). This automatic perfection also extends to a transfer of a health-care-insurance receivable TO a health-care provider. Those transfers normally will be made by natural persons who receive health-care services; there is little value in requiring filing for perfection in that context. Automatic perfection also applies to security interests created by sales of payment intangibles and promissory notes. Section 9-308 provides that a perfected security interest in collateral supported by a "supporting obligation" (such as an account supported by a guaranty) also is a perfected security interest in the supporting obligation, and that a perfected security interest in an obligation secured by a security interest or lien on property (e.g., a real property mortgage) also is a perfected security interest in the security interest or lien.

e. **Priority; Special Rules for Banks and Deposit Accounts.** The rules governing priority of security interests and agricultural liens are found in part 3, subpart 3 (sections 9-317 through 9-339). This article includes several new priority rules and some special rules relating to banks and deposit accounts found in part 3, subpart 4 (sections 9-340 through 9-342).

Purchase-money security interests: General; consumer-goods transactions; inventory. Section 9-103 substantially rewrites the definition of purchase-money security interest (PMSI) (although the term is not formally "defined"). The substantive changes, however, apply only to nonconsumer goods transactions. (Consumer transactions and consumer goods transactions are discussed below in comment 4(j)). For nonconsumer goods transactions, section 9-103 makes clear that a security interest in collateral may be (to some extent) both a PMSI as well as a non-PMSI, in accord with the "dual status" rule applied by some courts under former article 9 (thereby rejecting the "transformation" rule). The definition provides an even broader conception of a PMSI in inventory, yielding a result that accords with private agreements entered into in response to the uncertainty under former article 9. It also treats consignments as purchase-money security interests in inventory. Section 9-324 revises the PMSI priority rules, but for the most part without material change in substance. Section 9-324 also clarifies the priority rules for competing PMSIs in the same collateral.

Purchase-money security interests in livestock; agricultural liens. Section 9-324 provides a special PMSI priority, similar to the inventory

PMSI priority rule, for livestock. Section 9-322 (which contains the baseline first-to-file-or-perfect priority rule) also recognizes special nonarticle 9 priority rules for agricultural liens, which can override the baseline first-in-time rule.

Purchase-money security interests in software. Section 9-324 contains a new priority rule for a software purchase-money security interest. (Section 9-102 includes a definition of "software.") Under section 9-103, a software PMSI includes a PMSI in software that is used in goods that are also subject to a PMSI. (Note also that the definition of "chattel paper" has been expanded to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods.)

Investment property. The priority rules for investment property are substantially similar to the priority rules found in former section 9-115, which was added in conjunction with the 1994 revisions to UCC article 8. Under section 9-328, if a secured party has control of investment property (sections 8-106 and 9-106), its security interest is senior to a security interest perfected in another manner (e.g., by filing). Also under section 9-328, security interests perfected by control generally rank according to the time that control is obtained or, in the case of a security entitlement or a commodity contract carried in a commodity account, the time when the control arrangement is entered into. This is a change from former section 9-115, under which the security interests ranked equally. However, as between a securities intermediary's security interest in a security entitlement that it maintains for the debtor and a security interest held by another secured party, the securities intermediary's security interest is senior.

Deposit accounts. This article's priority rules applicable to deposit accounts are found in section 9-327. They are patterned on and are similar to those for investment property in former section 9-115 and section 9-328 of this article. Under section 9-327, if a secured party has control of a deposit account, its security interest is senior to a security interest perfected in another manner (i.e., as cash proceeds). Also under section 9-327, security interests perfected by control rank according to the time that control is obtained, but as between a depositary bank's security interest and one held by another secured party, the depositary bank's security interest is senior. A corresponding rule in section 9-340 makes a depositary bank's right of set-off generally senior to a security interest held by another secured party. However, if the other secured party becomes the depositary bank's customer with respect to the deposit account, then its security interest is senior to the depositary bank's security interest and right of set-off. Sections 9-327 and 9-340.

Letter-of-credit rights. The priority rules for security interests in letter-of-credit rights are found in section 9-329. They are somewhat analogous to those for deposit accounts. A security interest perfected by control has priority over one perfected in another manner (i.e., as a supporting obligation for the collateral in which a security interest is perfected). Security interests in a letter-of-credit right perfected by control rank according to the time that control is obtained. However, the rights of a transferee beneficiary or a nominated person are independent and superior to the extent provided in section 5-114. See section 9-109(c)(4).

Chattel paper and instruments. Section 9-330 is the successor to former section 9-308. As under former section 9-308, differing priority rules apply to purchasers of chattel paper who give new value and take possession (or, in the case of electronic chattel paper, obtain control) of the collateral depending on whether a conflicting security interest in the collateral is claimed merely as proceeds. The principal change relates to the role of knowledge and the effect of an indication of a previous assignment of the collateral. Section 9-330 also affords priority to purchasers of instruments who take possession in good faith and without knowledge that the purchase violates the rights of the competing secured party. In addition, to qualify for priority, purchasers of chattel paper, but not of instruments, must purchase in the ordinary course of business.

Proceeds. Section 9-322 contains new priority rules that clarify when a special priority of a security interest in collateral continues or does not continue with respect to proceeds of the collateral. Other refinements to the priority rules for proceeds are included in sections 9-324 (purchase-money security interest priority) and 9-330 (priority of certain purchasers of chattel paper and instruments).

Miscellaneous priority provisions. This article also includes: (i) Clarifications of selected good-faith-purchase and similar issues (sections 9-317 and 9-331); (ii) new priority rules to deal with the "double debtor" problem arising when a debtor creates a security interest in collateral acquired by the debtor subject to a security interest created by another person (section 9-325); (iii) new priority rules to deal with the problems created when a change in corporate structure or the like results in a new entity that has become bound by the original debtor's after-acquired property agreement (section 9-326); (iv) a provision enabling most transferees of funds from a deposit account or money to take free of a security interest (section 9-332); (v) substantially rewritten and refined priority rules dealing with accessions and commingled goods (sections 9-335 and 9-336); (vi) revised priority rules for security interests in goods covered by a certificate of title (section

9-337); and (vii) provisions designed to ensure that security interests in deposit accounts will not extend to most transferees of funds on deposit or payees from deposit accounts and will not otherwise "clog" the payments system (sections 9-341 and 9-342).

Model provisions relating to production-money security interests. Appendix II to this Article contains model definitions and priority rules relating to "production-money security interests" held by secured parties who give new value used in the production of crops. Because no consensus emerged on the wisdom of these provisions during the drafting process, the sponsors make no recommendation on whether these model provisions should be enacted.

f. **Proceeds.** Section 9-102 contains an expanded definition of "proceeds" of collateral which includes additional rights and property that arise out of collateral, such as distributions on account of collateral and claims arising out of the loss or nonconformity of, defects in, or damage to collateral. The term also includes collections on account of "supporting obligations," such as guarantees.

g. **Part 4: Additional Provisions Relating to Third-Party Rights.** New part 4 contains several provisions relating to the relationships between certain third parties and the parties to secured transactions. It contains new sections 9-401 (replacing former section 9-311) (alienability of debtor's rights), 9-402 (replacing former section 9-317) (secured party not obligated on debtor's contracts), 9-403 (replacing former section 9-206) (agreement not to assert defenses against assignee), 9-404, 9-405, and 9-406 (replacing former section 9-318) (rights acquired by assignee, modification of assigned contract, discharge of account debtor, restrictions on assignment of account, chattel paper, promissory note, or payment intangible ineffective), and 9-407 (replacing some provisions of former section 2A-303) (restrictions on creation or enforcement of security interest in leasehold interest or lessor's residual interest ineffective). It also contains new sections 9-408 (restrictions on assignment of promissory notes, health-care-insurance receivables ineffective, and certain general intangibles ineffective) and 9-409 (restrictions on assignment of letter-of-credit rights ineffective), which are discussed above.

h. **Filing.** Part 5 (formerly part 4) of article 9 has been substantially rewritten to simplify the statutory text and to deal with numerous problems of interpretation and implementation that have arisen over the years.

Medium-neutrality. This article is "medium-neutral"; that is, it makes clear that parties may file and otherwise communicate with a filing office by means of records communicated and stored in media other than on paper.

Identity of person who files a record; authorization. Part 5 is largely indifferent as to the person who effects a filing. Instead, it addresses whose authorization is necessary for a person to file a record with a filing office. The filing scheme does not contemplate that the identity of a "filer" will be a part of the searchable records. This approach is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system (except to the extent that filing offices may choose to employ authentication procedures in connection with electronic communications). As long as the appropriate person authorizes the filing, or, in the case of a termination statement, the debtor is entitled to the termination, it is largely insignificant whether the secured party or another person files any given record.

Section 9-509 collects in one place most of the rules that determine when a record may be filed. In general, the debtor's authorization is required for the filing of an initial financing statement or an amendment that adds collateral. With one further exception, a secured party of record's authorization is required for the filing of other amendments. The exception arises if a secured party has failed to provide a termination statement that is required because there is no outstanding secured obligation or commitment to give value. In that situation, a debtor is authorized to file a termination statement indicating that it has been filed by the debtor.

Financing statement formal requisites. The formal requisites for a financing statement are set out in section 9-502. A financing statement must provide the name of the debtor and the secured party and an indication of the collateral that it covers. Sections 9-503 and 9-506 address the sufficiency of a name provided on a financing statement and clarify when a debtor's name is correct and when an incorrect name is insufficient. Section 9-504 addresses the indication of collateral covered. Under section 9-504, a super-generic description (e.g., "all assets" or "all personal property") in a financing statement is a sufficient indication of the collateral. (Note, however, that a super-generic description is inadequate for purposes of a security agreement. See sections 9-108 and 9-203.) To facilitate electronic filing, this article does not require that the debtor's signature or other authorization appear on a financing statement. Instead, it prohibits the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition. See sections 9-509 and 9-626.

Filing-office operations. Part 5 contains several provisions governing filing operations. First, it prohibits the filing office from rejecting an initial financing statement or other record for a reason other than one of the few that are specified. See sections 9-516 and 9-520. Second, the filing office is obliged to link all subsequent records (e.g., assignments, continuation statements, etc.) to the initial financing statement to which they relate. See section 9-519. Third, the filing office may delete a financing statement and related records from the files no earlier than one year after lapse (lapse normally is five years after the filing date), and then only if a continuation statement has not been filed. See sections 9-515, 9-519, and 9-522. Thus, a financing statement and related records would be discovered by a search of the files even after the filing of a termination statement. This approach helps eliminate filing-office discretion and also eases problems associated with multiple secured parties and multiple partial assignments. Fourth, part 5 mandates performance standards for filing offices. See sections 9-519, 9-520, and 9-523. Fifth, it provides for the promulgation of filing-office rules to deal with details best left out of the statute and requires the filing office to submit periodic reports. See sections 9-526 and 9-527.

Correction of records: Defaulting or missing secured parties and fraudulent filings. In some areas of the country, serious problems have arisen from fraudulent financing statements that are filed against public officials and other persons. This article addresses the fraud problem by providing the opportunity for a debtor to file a termination statement when a secured party wrongfully refuses or fails to provide a termination statement. See section 9-509. This opportunity also addresses the problem of secured parties that simply disappear through mergers or liquidations. In addition, section 9-518 affords a statutory method by which a debtor who believes that a filed record is inaccurate or was wrongfully filed may indicate that fact in the files by filing a correction statement, albeit without affecting the efficacy, if any, of the challenged record.

Extended period of effectiveness for certain financing statements. Section 9-515 contains an exception to the usual rule that financing statements are effective for five years unless a continuation statement is filed to continue the effectiveness for another five years. Under that section, an initial financing statement filed in connection with a "public-finance transaction" or a "manufactured-home transaction" (terms defined in section 9-102) is effective for 30 years.

National form of financing statement and related forms. Section 9-521 provides for uniform, national written forms of financing statements and related written records that must be accepted by a filing office that accepts written records.

i. **Default and Enforcement.** Part 6 of article 9 extensively revises former part 5. Provisions relating to enforcement of consumer-goods transactions and consumer transactions are discussed in comment 4(j).

Debtor, secondary obligor; waiver. Section 9-602 clarifies the identity of persons who have rights and persons to whom a secured party owes specified duties under part 6. Under that section, the rights and duties are enjoyed by and run to the "debtor," defined in section 9-102 to mean any person with a nonlien property interest in collateral, and to any "obligor." However, with one exception (section 9-616, as it relates to a consumer obligor), the rights and duties concerned affect nondebtor obligors only if they are "secondary obligors." "Secondary obligor" is defined in section 9-102 to include one who is secondarily obligated on the secured obligation, e.g., a guarantor, or one who has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. However, under section 9-628, the secured party is relieved from any duty or liability to any person unless the secured party knows that the person is a debtor or obligor. Resolving an issue on which courts disagreed under former article 9, this article generally prohibits waiver by a secondary obligor of its rights and a secured party's duties under part 6. See section 9-602. However, section 9-624 permits a secondary obligor or debtor to waive the right to notification of disposition of collateral and, in a nonconsumer transaction, the right to redeem collateral, if the secondary obligor or debtor agrees to do so after default.

Rights of collection and enforcement of collateral. Section 9-607 explains in greater detail than former 9-502 the rights of a secured party who seeks to collect or enforce collateral, including accounts, chattel paper, and payment intangibles. It also sets forth the enforcement rights of a depositary bank holding a security interest in a deposit account maintained with the depositary bank. Section 9-607 relates solely to the rights of a secured party vis-a-vis a debtor with respect to collections and enforcement. It does not affect the rights or duties of third parties, such as account debtors on collateral, which are addressed elsewhere (e.g., section 9-406). Section 9-608 clarifies the manner in which proceeds of collection or enforcement are to be applied.

Disposition of collateral: Warranties of title. Section 9-610 imposes on a secured party who disposes of collateral the warranties of title, quiet possession, and the like that are otherwise applicable under other law. It also provides rules for the exclusion or modification of those warranties.

Disposition of collateral: Notification, application of proceeds, surplus and deficiency, other effects. Section 9-611 requires a secured party to give notification of a disposition of collateral to other secured parties and lienholders who have filed financing statements against the debtor covering the collateral. (That duty was eliminated by the 1972 revisions to article 9.) However, that section relieves the secured party from that duty when the secured party undertakes a search of the records and a report of the results is unreasonably delayed. Section 9-613, which applies only to nonconsumer transactions, specifies the contents of a sufficient notification of disposition and provides that a notification sent 10 days or more before the earliest time for disposition is sent within a reasonable time. Section 9-615 addresses the application of proceeds of disposition, the entitlement of a debtor to any surplus, and the liability of an obligor for any deficiency. Section 9-619 clarifies the effects of a disposition by a secured party, including the rights of transferees of the collateral.

Rights and duties of secondary obligor. Section 9-618 provides that a secondary obligor obtains the rights and assumes the duties of a secured party if the secondary obligor receives an assignment of a secured obligation, agrees to assume the secured party's rights and duties upon a transfer to it of collateral, or becomes subrogated to the rights of the secured party with respect to the collateral. The assumption, transfer, or subrogation is not a disposition of collateral under section 9-610, but it does relieve the former secured party of further duties. Former section 9-504(5) did not address whether a secured party was relieved of its duties in this situation.

Transfer of record or legal title. Section 9-619 contains a new provision making clear that a transfer of record or legal title to a secured party is not of itself a disposition under part 6. This rule applies regardless of the circumstances under which the transfer of title occurs.

Strict foreclosure. Section 9-620, unlike former section 9-505, permits a secured party to accept collateral in partial satisfaction, as well as full satisfaction, of the obligations secured. This right of strict foreclosure extends to intangible as well as tangible property. Section 9-622 clarifies the effects of an acceptance of collateral on the rights of junior claimants. It rejects the approach taken by some courts—deeming a secured party to have constructively retained collateral in satisfaction of the secured obligations—in the case of a secured party's unreasonable delay in the disposition of collateral. Instead, unreasonable delay is relevant when determining whether a disposition under section 9-610 is commercially reasonable.

Effect of noncompliance: "Rebuttable presumption" test. Section 9-626 adopts the "rebuttable presumption" test for the failure of a secured party to proceed in accordance with certain provisions of part 6. Under this approach, the deficiency claim of a noncomplying secured party is calculated by crediting the obligor with the greater of the actual net proceeds of a disposition and the amount of net proceeds that would have been realized if the disposition had been conducted in accordance with part 6 (e.g., in a commercially reasonable manner). Section 9-626 rejects the "absolute bar" test that some courts have imposed; that approach bars a noncomplying secured party from recovering any deficiency, regardless of the loss (if any) the debtor suffered as a consequence of the noncompliance.

"Low-price" dispositions: Calculation of deficiency and surplus. Section 9-615(f) addresses the problem of procedurally regular dispositions that fetch a low price. Subsection (f) provides a special method for calculating a deficiency if the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought." ("Person related to" is defined in section 9-102.) In these situations there is reason to suspect that there may be inadequate incentives to obtain a better price. Consequently, instead of calculating a deficiency (or surplus) based on the actual net proceeds, the deficiency (or surplus) would be calculated based on the proceeds that would have been received in a disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor.

j. **Consumer Goods, Consumer-Goods Transactions, and Consumer Transactions.** This article (including the accompanying conforming revisions) includes several special rules for "consumer goods," "consumer transactions," and "consumer-goods transactions." Each term is defined in section 9-102.

(i) Revised sections 2-502 and 2-716 provide a buyer of consumer goods with enhanced rights to possession of the goods, thereby accelerating the opportunity to achieve "buyer in ordinary course of business" status under section 1-201.

(ii) Section 9-103(e) (allocation of payments for determining extent of purchase-money status), (f) (purchase-money status not affected by cross-collateralization, refinancing, restructuring, or the like), and (g) (secured party has burden of establishing extent of purchase-money status) do not apply to consumer-goods transactions. Section 9-103 also provides that the limitation of those provisions to transactions other than consumer-goods transactions leaves to the courts the proper rules for consumer-goods transactions and prohibits the courts from drawing inferences from that limitation.

(iii) Section 9-108 provides that in a consumer transaction a description of consumer goods, a security entitlement, securities account, or commodity account "only by (UCC-defined) type of collateral" is not a sufficient collateral description in a security agreement.

(iv) Sections 9-403 and 9-404 make effective the Federal Trade Commission's antiholder-in-due-course rule (when applicable), 16 C.F.R. part 433, even in the absence of the required legend.

(v) The 10-day safe-harbor for notification of a disposition provided by section 9-612 does not apply in a consumer transaction.

(vi) Section 9-613 (contents and form of notice of disposition) does not apply to a consumer-goods transaction.

(vii) Section 9-614 contains special requirements for the contents of a notification of disposition and a safe-harbor, "plain English" form of notification, for consumer-goods transactions.

(viii) Section 9-616 requires a secured party in a consumer-goods transaction to provide a debtor with a notification of how it calculated a deficiency at the time it first undertakes to collect a deficiency.

(ix) Section 9-620 prohibits partial strict foreclosure with respect to consumer goods collateral and, unless the debtor agrees to waive the requirement in an authenticated record after default, in certain cases requires the secured party to dispose of consumer goods collateral which has been repossessed.

(x) Section 9-626 ("rebuttable presumption" rule) does not apply to a consumer transaction. Section 9-626 also provides that its limitation to transactions other than consumer transactions leaves to the courts the proper rules for consumer transactions and prohibits the courts from drawing inferences from that limitation.

k. **Good Faith.** Section 9-102 contains a new definition of "good faith" that includes not only "honesty in fact" but also "the observance of reasonable commercial standards of fair dealing." The definition is similar to the ones adopted in connection with other, recently completed revisions of the UCC.

l. **Transition Provisions.** Part 7 (sections 9-701 through 9-709) contains transition provisions. Transition from former article 9 to this article will be particularly challenging in view of its expanded scope, its modification of choice of law rules for perfection and priority, and its expansion of the methods of perfection.

m. **Conforming and Related Amendments to Other UCC Articles.** Appendix I contains several proposed revisions to the provisions and Comments of other UCC articles. For the most part the revisions are explained in the Comments to the proposed revisions. Cross-references in other UCC articles to sections of Article 9 also have been revised.

Article 1. Revised section 1-201 contains revisions to the definitions of "buyer in ordinary course of business," "purchaser," and "security interest."

Articles 2 and 2A. Sections 2-210, 2-326, 2-502, 2-716, 2A-303, and 2A-307 have been revised to address the intersection between articles 2 and 2A and article 9.

Article 5. New section 5-118 is patterned on section 4-210. It provides for a security interest in documents presented under a letter of credit in favor of the issuer and a nominated person on the letter of credit.

Article 8. Revisions to section 8-106, which deals with "control" of securities and security entitlements, conform it to section 8-302, which deals with "delivery." Revisions to section 8-110, which deals with a "securities intermediary's jurisdiction," conform it to the revised treatment of a "commodity intermediary's jurisdiction" in section 9-305. Sections 8-301 and 8-302 have been revised for clarification. Section 8-510 has been revised to conform it to the revised priority rules of section 9-328. Several comments in article 8 also have been revised.

Cross References. — As to inapplicability of Article 9 to any security interest created in connection with the issuance of bonds under G.S. 115C-513, see G.S. 115C-513(b).

Legal Periodicals. — For article concerning liens on personal property not governed by the UCC, see 44 N.C.L. Rev. 322 (1966).

For symposium on the UCC in North Carolina, see 44 N.C.L. Rev. 525 (1966).

For case law survey as to credit transactions, see 44 N.C.L. Rev. 956 (1966).

For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For symposium on the UCC, see 18 Wake Forest L. Rev. 161 (1982).

For survey of 1982 commercial law, see 61 N.C.L. Rev. 1018 (1983).

For 1984 survey, "The Application of the North Carolina Motor Vehicle Act and the Uniform Commercial Code to the Sale of Motor Vehicles by Consignment," see 63 N.C.L. Rev. 1105 (1985).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Certainty, Efficiency, and Realism: Rights in Collateral Under Article 9 of the Uniform Commercial Code," see 73 N.C.L. Rev. 115 (1994).

For 1997 legislative survey, see 20 Campbell L. Rev. 401.

For article, "U.C.C. Revised Article 9: The Transition Rules," see 79 N.C.L. Rev. 993 (2001).

For article, "Recent Developments: U.C.C. Revised Article 9: Can Domain Names Provide Security for New Economy Businesses?," see 79 N.C.L. Rev. 1178 (2001).

Editor's Note. — Session Laws 2000-169, s. 1, effective July 1, 2001, rewrote Article 9 of Chapter 25 of the Uniform Commercial Code. At the end of Article 9 are tables showing comparable sections and their disposition in new Article 9. This revised Article 9 supersedes the revision of Article 9 by Session Laws 1975, c. 862, s. 1. Where appropriate, historical citations to sections of former Article 9 have been placed under corresponding sections of revised Article 9.

Session Laws 2000-169, s. 49, directs the Revisor of Statutes to cause to be printed along with the act all relevant portions of the official comments to the Uniform Commercial Code, Revised Article 9 and conforming amendments to Articles 1, 2, 2A, 4, 5, 6, 7, and 8 and all explanatory comments of the drafters of this act as the Revisor deems appropriate.

Session Laws 2001-218, s. 6, provides: "The Revisor of Statutes shall cause to be printed along with the portions of this act amending Article 9 of Chapter 25 of the General Statutes, such North Carolina official comments explaining the amendments made by this act as the Revisor deems appropriate."

§ 25-9-102. Definitions and index of definitions.

(a) Article 9 definitions. — In this Article:

(1) "Accession" means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(2) "Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state, or person licensed or authorized to operate the game by a state or governmental unit of a state. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

(3) "Account debtor" means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.

(4) "Accounting", except as used in "accounting for", means a record:

a. Authenticated by a secured party;

b. Indicating the aggregate unpaid secured obligations as of a date not more than 35 days earlier or 35 days later than the date of the record; and

c. Identifying the components of the obligations in reasonable detail.

(5) "Agricultural lien" means an interest, other than a security interest, in farm products:

a. Which secures payment or performance of an obligation for:

1. Goods or services furnished in connection with a debtor's farming operation; or

    2. Rent on real property leased by a debtor in connection with its farming operation;
  b. Which is created by statute in favor of a person that:
    1. In the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
    2. Leased real property to a debtor in connection with the debtor's farming operation; and
  c. Whose effectiveness does not depend on the person's possession of the personal property.

(6) "As-extracted collateral" means:
  a. Oil, gas, or other minerals that are subject to a security interest that:
    1. Is created by a debtor having an interest in the minerals before extraction; and
    2. Attaches to the minerals as extracted; or
  b. Accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.

(7) "Authenticate" means:
  a. To sign; or
  b. To execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

(8) "Bank" means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.

(9) "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.

(10) "Certificate of title" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

(11) "Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this subdivision, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

(12) "Collateral" means the property subject to a security interest or agricultural lien. The term includes:
  a. Proceeds to which a security interest attaches;
  b. Accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and
  c. Goods that are the subject of a consignment.

(13) "Commercial tort claim" means a claim arising in tort with respect to which:
  a. The claimant is an organization; or
  b. The claimant is an individual and the claim:
    1. Arose in the course of the claimant's business or profession; and
    2. Does not include damages arising out of personal injury to or the death of an individual.

(14) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(15) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is:
  a. Traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or
  b. Traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(16) "Commodity customer" means a person for which a commodity intermediary carries a commodity contract on its books.

(17) "Commodity intermediary" means a person that:
  a. Is registered as a futures commission merchant under federal commodities law; or
  b. In the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.

(18) "Communicate" means:
  a. To send a written or other tangible record;
  b. To transmit a record by any means agreed upon by the persons sending and receiving the record; or
  c. In the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

(19) "Consignee" means a merchant to which goods are delivered in a consignment.

(20) "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:
  a. The merchant:
    1. Deals in goods of that kind under a name other than the name of the person making delivery;
    2. Is not an auctioneer; and
    3. Is not generally known by its creditors to be substantially engaged in selling the goods of others;
  b. With respect to each delivery, the aggregate value of the goods is one thousand dollars ($1,000) or more at the time of delivery;
  c. The goods are not consumer goods immediately before delivery; and
  d. The transaction does not create a security interest that secures an obligation.

(21) "Consignor" means a person that delivers goods to a consignee in a consignment.

(22) "Consumer debtor" means a debtor in a consumer transaction.

(23) "Consumer goods" means goods that are used or bought for use primarily for personal, family, or household purposes.

(24) "Consumer-goods transaction" means a consumer transaction in which:

a. An individual incurs an obligation primarily for personal, family, or household purposes; and
b. A security interest in consumer goods secures the obligation.

(25) "Consumer obligor" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.

(26) "Consumer transaction" means a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.

(27) "Continuation statement" means an amendment of a financing statement which:
a. Identifies, by its file number, the initial financing statement to which it relates; and
b. Indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.

(28) "Debtor" means:
a. A person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;
b. A seller of accounts, chattel paper, payment intangibles, or promissory notes; or
c. A consignee.

(29) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

(30) "Document" means a document of title or a receipt of the type described in G.S. 25-7-201(b).

(31) "Electronic chattel paper" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.

(32) "Encumbrance" means a right, other than an ownership interest, in real property. The term includes mortgages and other liens on real property.

(33) "Equipment" means goods other than inventory, farm products, or consumer goods.

(34) "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:
a. Crops grown, growing, or to be grown, including:
  1. Crops produced on trees, vines, and bushes; and
  2. Aquatic goods produced in aquacultural operations;
b. Livestock, born or unborn, including aquatic goods produced in aquacultural operations;
c. Supplies used or produced in a farming operation; or
d. Products of crops or livestock in their unmanufactured states.

(35) "Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

(36) "File number" means the number assigned to an initial financing statement pursuant to G.S. 25-9-519(a).

(37) "Filing office" means an office designated in G.S. 25-9-501 as the place to file a financing statement.

(38) "Filing-office rule" means a rule adopted pursuant to G.S. 25-9-526.

(39) "Financing statement" means a record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

(40) "Fixture filing" means the filing of a financing statement covering goods that are or are to become fixtures and satisfying G.S. 25-9-502(a) and (b). The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.

(41) "Fixtures" means goods that have become so related to particular real property that an interest in them arises under real property law.

(42) "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.

(43) Repealed by Session Laws 2006-112, s. 21, effective October 1, 2006.

(44) "Goods" means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

(45) "Governmental unit" means a subdivision, agency, department, county, parish, municipality, or other unit of the government of the United States, a state, or a foreign country. The term includes an organization having a separate corporate existence if the organization (i) is eligible to issue debt on which interest is exempt from income taxation under the laws of the United States, or (ii) was created to facilitate the issuance of notes, bonds, other evidences of indebtedness or payment obligations for borrowed money by, or in conjunction with, installment or lease purchase financings for, this State or any county, municipality, or other agency or political subdivision thereof as evidenced by the documents creating the organization.

(46) "Health-care-insurance receivable" means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided.

(47) "Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

(48) "Inventory" means goods, other than farm products, which:
  a. Are leased by a person as lessor;

b. Are held by a person for sale or lease or to be furnished under a contract of service;
c. Are furnished by a person under a contract of service; or
d. Consist of raw materials, work in process, or materials used or consumed in a business.

(49) "Investment property" means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

(50) "Jurisdiction of organization", with respect to a registered organization, means the jurisdiction under whose law the organization is organized.

(51) "Letter-of-credit right" means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

(52) "Lien creditor" means:
a. A creditor that has acquired a lien on the property involved by attachment, levy, or the like;
b. An assignee for benefit of creditors from the time of assignment;
c. A trustee in bankruptcy from the date of the filing of the petition; or
d. A receiver in equity from the time of appointment.

(53) "Manufactured home" means a structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or 40 body feet or more in length, or, when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein. The term includes any structure that meets all of the requirements of this subdivision except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under Title 42 of the United States Code.

(54) "Manufactured-home transaction" means a secured transaction:
a. That creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or
b. In which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

(55) "Mortgage" means a consensual interest in real property, including fixtures, which secures payment or performance of an obligation.

(56) "New debtor" means a person that becomes bound as debtor under G.S. 25-9-203(d) by a security agreement previously entered into by another person.

(57) "New value" means (i) money, (ii) money's worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.

(58) "Noncash proceeds" means proceeds other than cash proceeds.

(59) "Obligor" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other perfor-

mance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.

(60) "Original debtor", except as used in G.S. 25-9-310(c), means a person that, as debtor, entered into a security agreement to which a new debtor has become bound under G.S. 25-9-203(d).

(61) "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary obligation.

(62) "Person related to", with respect to an individual, means:
  a. The spouse of the individual;
  b. A brother, brother-in-law, sister, or sister-in-law of the individual;
  c. An ancestor or lineal descendant of the individual or the individual's spouse; or
  d. Any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home with the individual.

(63) "Person related to", with respect to an organization, means:
  a. A person directly or indirectly controlling, controlled by, or under common control with the organization;
  b. An officer or director of, or a person performing similar functions with respect to, the organization;
  c. An officer or director of, or a person performing similar functions with respect to, a person described in sub-subdivision a. of this subdivision;
  d. The spouse of an individual described in sub-subdivision a., b., or c. of this subdivision; or
  e. An individual who is related by blood or marriage to an individual described in sub-subdivision a., b., c., or d. of this subdivision and shares the same home with the individual.

(64) "Proceeds", except as used in G.S. 25-9-609(b), means the following property:
  a. Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
  b. Whatever is collected on, or distributed on account of, collateral;
  c. Rights arising out of collateral;
  d. To the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or
  e. To the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

(65) "Production-money crops" means crops that secure a production-money obligation incurred with respect to the production of those crops.

(66) "Production-money obligation" means an obligation of an obligor incurred for new value given to enable the debtor to produce crops if the value is in fact used for the production of the crops.

(67) "Production of crops" includes tilling and otherwise preparing land for growing, planting, cultivating, fertilizing, irrigating, harvesting, gathering, and curing crops, and protecting them from damage or disease.

(68) "Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

(69) "Proposal" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to G.S. 25-9-620, 25-9-621, and 25-9-622.

(70) "Public-finance transaction" means a secured transaction in connection with which:
   a. Debt securities are issued;
   b. All or a portion of the securities issued have an initial stated maturity of at least 20 years; and
   c. The debtor, obligor, secured party, account debtor or other person obligated on collateral, assignor or assignee of a secured obligation, or assignor or assignee of a security interest is a state or a governmental unit of a state.

(71) "Pursuant to commitment", with respect to an advance made or other value given by a secured party, means pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(72) "Record", except as used in "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(73) "Registered organization" means an organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to have been organized.

(74) "Secondary obligor" means an obligor to the extent that:
   a. The obligor's obligation is secondary; or
   b. The obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.

(75) "Secured party" means:
   a. A person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;
   b. A person that holds an agricultural lien;
   c. A consignor;
   d. A person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;
   e. A trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or
   f. A person that holds a security interest arising under G.S. 25-2-401, 25-2-505, 25-2-711(3), 25-2A-508(5), 25-4-208, or 25-5-118.

(76) "Security agreement" means an agreement that creates or provides for a security interest.

(77) "Send", in connection with a record or notification, means:
   a. To deposit in the mail, deliver for transmission, or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or
   b. To cause the record or notification to be received within the time that it would have been received if properly sent under sub-subdivision a. of this subdivision.

(78) "Software" means a computer program and any supporting information provided in connection with a transaction relating to the pro-

gram. The term does not include a computer program that is included in the definition of goods.

(79) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(80) "Supporting obligation" means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

(81) "Tangible chattel paper" means chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium.

(82) "Termination statement" means an amendment of a financing statement which:
a. Identifies, by its file number, the initial financing statement to which it relates; and
b. Indicates either that it is a termination statement or that the identified financing statement is no longer effective.

(83) "Transmitting utility" means a person primarily engaged in the business of:
a. Operating a railroad, subway, street railway, or trolley bus;
b. Transmitting communications electrically, electromagnetically, or by light;
c. Transmitting goods by pipeline or sewer; or
d. Transmitting or producing and transmitting electricity, steam, gas, or water.

(b) Definitions in other articles. — "Control" as provided in G.S. 25-7-106 and the following definitions in other Articles of this Chapter apply to this Article:

"Applicant"	G.S. 25-5-102.
"Beneficiary"	G.S. 25-5-102.
"Broker"	G.S. 25-8-102.
"Certificated security"	G.S. 25-8-102.
"Check"	G.S. 25-3-104.
"Clearing corporation"	G.S. 25-8-102.
"Contract for sale"	G.S. 25-2-106.
"Customer"	G.S. 25-4-104.
"Entitlement holder"	G.S. 25-8-102.
"Financial asset"	G.S. 25-8-102.
"Holder in due course"	G.S. 25-3-302.
"Issuer" (with respect to a letter of credit or letter-of-credit right)	G.S. 25-5-102.
"Issuer" (with respect to a security)	G.S. 25-8-201.
"Issuer" (with respect to documents of title)	G.S. 25-7-102.
"Lease"	G.S. 25-2A-103.
"Lease agreement"	G.S. 25-2A-103.
"Lease contract"	G.S. 25-2A-103.
"Leasehold interest"	G.S. 25-2A-103.
"Lessee"	G.S. 25-2A-103.
"Lessee in ordinary course of business"	G.S. 25-2A-103.
"Lessor"	G.S. 25-2A-103.
"Lessor's residual interest"	G.S. 25-2A-103.
"Letter of credit"	G.S. 25-5-102.
"Merchant"	G.S. 25-2-104.
"Negotiable instrument"	G.S. 25-3-104.

"Nominated person"	G.S. 25-5-102.
"Note"	G.S. 25-3-104.
"Proceeds of a letter of credit"	G.S. 25-5-114.
"Prove"	G.S. 25-3-103.
"Sale"	G.S. 25-2-106.
"Securities account"	G.S. 25-8-501.
"Securities intermediary"	G.S. 25-8-102.
"Security"	G.S. 25-8-102.
"Security certificate"	G.S. 25-8-102.
"Security entitlement"	G.S. 25-8-102.
"Uncertificated security"	G.S. 25-8-102.

(c) Article 1 definitions and principles. — Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(g); 1997-181, s. 3; 1997-456, s. 4; 1999-73, s. 6; 2000-169, s. 1; 2001-218, s. 1; 2006-112, ss. 21, 44.)

OFFICIAL COMMENT

1. **Source.** All terms that are defined in article 9 and used in more than one section are consolidated in this section. Note that the definition of "security interest" is found in section 1-201, not in this article, and has been revised. Many of the definitions in this section are new; many others derive from those in former section 9-105. The following comments also indicate other sections of former article 9 that defined (or explained) terms.

2. **Parties to Secured Transactions.**

a. **"Debtor"; "Obligor"; "Secondary Obligor."** Determining whether a person was a "debtor" under former section 9-105(1)(d) required a close examination of the context in which the term was used. To reduce the need for this examination, this article redefines "debtor" and adds new defined terms, "secondary obligor" and "obligor." In the context of part 6 (default and enforcement), these definitions distinguish among three classes of persons: (i) Those persons who may have a stake in the proper enforcement of a security interest by virtue of their nonlien property interest (typically, an ownership interest) in the collateral; (ii) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt; and (iii) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary or if the obligor has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. One must consult the law of suretyship to determine whether an obligation is secondary. The Restatement (3d), Suretyship and Guaranty section 1 (1996), contains a useful explanation of the concept. Obligors in the third class are neither debtors nor secondary obligors. With one exception (section 9-616, as it relates to a consumer obligor), the rights and duties provided by Part 6 affect nondebtor obligors only if they are "secondary obligors."

By including in the definition of "debtor" all persons with a property interest (other than a security interest in or other lien on collateral), the definition includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee's identity. Exculpatory provisions in part 6 protect the secured party in that circumstance. See sections 9-605 and 9-628. The definition renders unnecessary former section 9-112, which governed situations in which collateral was not owned by the debtor. The definition also includes a "consignee," as defined in this section, as well as a seller of accounts, chattel paper, payment intangibles, or promissory notes.

Secured parties and other lienholders are excluded from the definition of "debtor" because the interests of those parties normally derive from and encumber a debtor's interest. However, if in a *separate* secured transaction a secured party grants, as *debtor*, a security interest in its own interest (i.e., its security interest and any obligation that it secures), the secured party is a debtor *in that transaction*. This typically occurs when a secured party with a security interest in specific goods assigns chattel paper.

Consider the following examples:

Example 1: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Behnfeldt is a debtor and an obligor.

Example 2: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno cosigns a negotiable note as maker. As before, Behnfeldt is the debtor and an obligor. As an accommodation party (see section 3-419), Bruno is a secondary obligor. Bruno has this status even if the note states that her obligation is a primary obligation and that she waives all suretyship defenses.

Example 3: Behnfeldt borrows money on an unsecured basis. Bruno cosigns the note and grants a security interest in her Honda to secure her obligation. Inasmuch as Behnfeldt does not have a property interest in the Honda, Behnfeldt is not a debtor. Having granted the security interest, Bruno is the debtor. Because Behnfeldt is a principal obligor, she is not a secondary obligor. Whatever the outcome of enforcement of the security interest against the Honda or Bruno's secondary obligation, Bruno will look to Behnfeldt for her losses. The enforcement will not affect Behnfeldt's aggregate obligations.

When the principal obligor (borrower) and the secondary obligor (surety) each has granted a security interest in different collateral, the status of each is determined by the collateral involved.

Example 4: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno cosigns the note and grants a security interest in her Honda to secure her obligation. When the secured party enforces the security interest in Behnfeldt's Miata, Behnfeldt is the debtor, and Bruno is a secondary obligor. When the secured party enforces the security interest in the Honda, Bruno is the "debtor." As in Example 3, Behnfeldt is an obligor, but not a secondary obligor.

b. **"Secured Party."** The secured party is the person in whose favor the security interest has been created, as determined by reference to the security agreement. This definition controls, among other things, which person has the duties and potential liability that part 6 imposes upon a secured party. The definition of "secured party" also includes a "consignor," a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold, and the holder of an agricultural lien.

The definition of "secured party" clarifies the status of various types of representatives. Consider, for example, a multi-bank facility under which Bank A, Bank B, and Bank C are lenders and Bank A serves as the collateral agent. If the security interest is granted to the banks, then they are the secured parties. If the security interest is granted to Bank A as collateral agent, then Bank A is the secured party.

c. **Other Parties.** A "consumer obligor" is defined as the obligor in a consumer transaction. Definitions of "new debtor" and "original debtor" are used in the special rules found in sections 9-326 and 9-508.

3. **Definitions Relating to Creation of a Security Interest.**

a. **"Collateral."** As under former section 9-105, "collateral" is the property subject to a security interest and includes accounts and chattel paper that have been sold. It has been expanded in this article. The term now explicitly includes proceeds subject to a security interest. It also reflects the broadened scope of the article. It includes property subject to an agricultural lien as well as payment intangibles and promissory notes that have been sold.

b. **"Security Agreement."** The definition of "security agreement" is substantially the same as under former section 9-105—an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former article 9 to refer to the document or writing that contained a debtor's security agreement. This article eliminates that usage, reserving the term for the more precise meaning specified in the definition.

Whether an agreement creates a security interest depends not on whether the parties intend that the law *characterize* the transaction as a security interest but rather on whether the transaction falls within the definition of "security interest" in section 1-201. Thus, an agreement that the parties characterize as a "lease" of goods may be a "security agreement," notwithstanding the parties' stated intention that the law treat the transaction as a lease and not as a secured transaction.

4. **Goods-Related Definitions.**

a. **"Goods"; "Consumer Goods"; "Equipment"; "Farm Products"; "Farming Operation"; "Inventory."** The definition of "goods" is substantially the same as the definition in former section 9-105. This article also retains the four mutually-exclusive "types" of collateral that consist of goods: "Consumer goods;" "equipment;" "farm products;" and "inventory." The revisions are primarily for clarification.

The classes of goods are mutually exclusive. For example, the same property cannot simultaneously be both equipment and inventory. In borderline cases—a physician's car or a farmer's truck that might be either consumer goods or equipment—the principal use to which the property is put is determinative. Goods can fall into different classes at different times. For example, a radio may be inventory in the hands of a dealer and consumer goods in the hands of a consumer. As under former article 9, goods are "equipment" if they do not fall into another category.

The definition of "consumer goods" follows former section 9-109. The classification turns on whether the debtor uses or bought the goods for use "primarily for personal, family, or household purposes."

Goods are inventory if they are leased by a lessor or held by a person for sale or lease. The revised definition of "inventory" makes clear that the term includes goods leased by the debtor to others as well as goods held for lease.

(The same result should have been obtained under the former definition.) Goods to be furnished or furnished under a service contract, raw materials, and work in process also are inventory. Implicit in the definition is the criterion that the sales or leases are or will be in the ordinary course of business. For example, machinery used in manufacturing is equipment, not inventory, even though it is the policy of the debtor to sell machinery when it becomes obsolete or worn. Inventory also includes goods that are consumed in a business (e.g., fuel used in operations). In general, goods used in a business are equipment if they are fixed assets or have, as identifiable units, a relatively long period of use, but are inventory, even though not held for sale or lease, if they are used up or consumed in a short period of time in producing a product or providing a service.

Goods are "farm products" if the debtor is engaged in farming operations with respect to the goods. Animals in a herd of livestock are covered whether the debtor acquires them by purchase or as a result of natural increase. Products of crops or livestock remain farm products as long as they have not been subjected to a manufacturing process. The terms "crops" and "livestock" are not defined. The new definition of "farming operations" is for clarification only.

Crops, livestock, and their products cease to be "farm products" when the debtor ceases to be engaged in farming operations with respect to them. If, for example, they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory. Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not specified in this article. At one end of the spectrum, some processes are so closely connected with farming—such as pasteurizing milk or boiling sap to produce maple syrup or sugar—that they would not constitute manufacturing. On the other hand an extensive canning operation would be manufacturing. Once farm products have been subjected to a manufacturing operation, they normally become inventory.

The revised definition of "farm products" clarifies the distinction between crops and standing timber and makes clear that aquatic goods produced in aquacultural operations may be either crops or livestock. Although aquatic goods that are vegetable in nature often would be crops and those that are animal would be livestock, this article leaves the courts free to classify the goods on a case-by-case basis. See section 9-324, comment 11.

The definitions of "goods" and "software" are also mutually exclusive. Computer programs usually constitute "software," and, as such, are not "goods" as this Article uses the terms. However, under the circumstances specified in the definition of "goods," computer programs embedded in goods are part of the "goods" and are not "software."

b. **"Accession"; "Manufactured Home"; "Manufactured-Home Transaction."** Other specialized definitions of goods include "accession" (see the special priority and enforcement rules in section 9-335) and "manufactured home" (see section 9-515, permitting a financing statement in a "manufactured-home transaction" to be effective for 30 years). The definition of "manufactured home" borrows from the federal Manufactured Housing Act, 42 U.S.C. section 5401 et seq., and is intended to have the same meaning.

c. **"As-Extracted Collateral."** Under this article, oil, gas, and other minerals that have not been extracted from the ground are treated as real property, to which this article does not apply. Upon extraction, minerals become personal property (goods) and eligible to be collateral under this article. See the definition of "goods," which excludes "oil, gas, and other minerals before extraction." To take account of financing practices reflecting the shift from real to personal property, this article contains special rules for perfecting security interests in minerals which attach upon extraction and in accounts resulting from the sale of minerals at the wellhead or minehead. See, e.g., sections 9-301(4) (law governing perfection and priority), 9-501 (place of filing), 9-502 (contents of financing statement), and 9-519 (indexing of records). The new term, "as-extracted collateral," refers to the minerals and related accounts to which the special rules apply. The term "at the wellhead" encompasses arrangements based on a sale of the produce at the moment that it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" of a well, the far side of a gathering tank, or at some other point. The term "at ... the minehead" is comparable.

The following examples explain the operation of these provisions.

Example 5: Debtor owns an interest in oil that is to be extracted. To secure Debtor's obligations to Lender, Debtor enters into an authenticated agreement granting Lender an interest in the oil. Although Lender may acquire an interest in the oil under real property law, Lender does not acquire a security interest under this article until the oil becomes personal property, i.e., until it is extracted and becomes "goods" to which this article applies. Because Debtor had an interest in the oil before extraction and Lender's security interest attached to the oil as extracted, the oil is "as-extracted collateral."

Example 6: Debtor owns an interest in oil that is to be extracted and contracts to sell the oil to Buyer at the wellhead. In an authenticated agreement, Debtor agrees to sell to Lender the right to payment from Buyer. This right to payment is an account that constitutes "as-extracted collateral." If Lender then resells the account to Financer, Financer acquires a security interest. However, inasmuch as the debtor-seller in that transaction, Lender, had no interest in the oil before extraction, Financer's collateral (the account it owns) is not "as-extracted collateral."

Example 7: Under the facts of example 6, before extraction, Buyer grants a security interest in the oil to Bank. Although Bank's security interest attaches when the oil is extracted, Bank's security interest is not in "as-extracted collateral," inasmuch as its debtor, Buyer, did not have an interest in the oil before extraction.

5. **Receivables-Related Definitions.**

a. **"Account"; "Health-Care-Insurance Receivable"; "As-Extracted Collateral."** The definition of "account" has been expanded and reformulated. It is no longer limited to rights to payment relating to goods or services. Many categories of rights to payment that were classified as general intangibles under former article 9 are accounts under this article. Thus, if they are sold, a financing statement must be filed to perfect the buyer's interest in them. Among the types of property that are expressly excluded from the definition is "a right to payment for money or funds advanced or sold." As defined in section 1-201, "money" is limited essentially to currency. As used in the exclusion from the definition of "account," however, "funds" is a broader concept (although the term is not defined). For example, when a bank-lender credits a borrower's deposit account for the amount of a loan, the bank's advance of funds is not a transaction giving rise to an account.

The definition of "health-care-insurance receivable" is new. It is a subset of the definition of "account." However, the rules generally applicable to account debtors on accounts do not apply to insurers obligated on health-care-insurance receivables. See sections 9-404(e), 9-405(d), and 9-406(i).

Note that certain accounts also are "as-extracted collateral." See comment 4(c), examples 6 and 7.

b. **"Chattel Paper"; "Electronic Chattel Paper"; "Tangible Chattel Paper."** "Chattel paper" consists of a monetary obligation together with a security interest in or a lease of specific goods if the obligation and security interest or lease are evidenced by "a record or records." The definition has been expanded from that found in former article 9 to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, or a lease of specific goods and license of software used in the goods. The expanded definition covers transactions in which the debtor's or lessee's monetary obligation includes amounts owed with respect to software used in the goods. The monetary obligation with respect to the software need not be owed under a license from the secured party or lessor, and the secured party or lessor need not be a party to the license transaction itself. Among the types of monetary obligations that are included in "chattel paper" are amounts that have been advanced by the secured party or lessor to enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods. The definition also makes clear that rights to payment arising out of credit-card transactions are not chattel paper.

Charters of vessels are expressly excluded from the definition of chattel paper; they are accounts. The term "charter" as used in this section includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage, and all other arrangements for the use of vessels.

Under former section 9-105, only if the evidence of an obligation consisted of "a writing or writings" could an obligation qualify as chattel paper. In this article, traditional, written chattel paper is included in the definition of "tangible chattel paper." "Electronic chattel paper" is chattel paper that is stored in an electronic medium instead of in tangible form. The concept of an electronic medium should be construed liberally to include electrical, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies.

The definition of electronic chattel paper does not dictate that it be created in any particular fashion. For example, a record consisting of a tangible writing may be converted to electronic form (e.g., by creating electronic images of a signed writing). Or, records may be initially created and executed in electronic form (e.g., a lessee might authenticate an electronic record of a lease that is then stored in electronic form). In either case the resulting records are electronic chattel paper.

c. **"Instrument"; "Promissory Note."** The definition of "instrument" includes a negotiable instrument. As under former section 9-105, it also includes any other right to payment of a monetary obligation that is evidenced by a writing of a type that in ordinary course of business is transferred by delivery (and, if necessary, an indorsement or assignment). Except in the case of chattel paper, the fact that an instrument is secured by a security interest or encumbrance on property does not change the character of the instrument as such or convert the combination of the instrument and collateral into a separate classification of personal property. The definition makes clear that rights to payment arising out of credit-card transactions are not instruments. The definition of "promissory note" is new, necessitated by the inclusion of sales of promissory notes within the scope of article 9. It explicitly excludes obligations arising out of "orders" to pay (e.g., checks) as opposed to "promises" to pay. See section 3-104.

d. **"General Intangible"; "Payment Intangible."** "General intangible" is the residual category of personal property, including things in action, that is not included in the other defined types of collateral. Examples are various categories of intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument. As used in the definition of "general intangible," "things in action" includes rights that arise under a license of intellectual property, including the right to exploit the intellectual property without liability for infringement. The definition has been revised to exclude commercial tort claims, deposit accounts, and letter-of-credit rights. Each of the three is a separate type of collateral. One important consequence of this exclusion is that tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter-of-credit rights) are not "account debtors" having the rights and obligations set forth in sections 9-404, 9-405, and 9-406. In particular, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in section 9-404(a). See comment 5(h). Another important consequence relates to the adequacy of the description in the security agreement. See section 9-108.

"Payment intangible" is a subset of the definition of "general intangible." The sale of a payment intangible is subject to this article. See section 9-109(a)(3). Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term "payment intangible," however, embraces only those general intangibles "under which the account debtor's *principal* obligation is a monetary obligation." (Emphasis added.)

In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, nonmonetary obligations. If the promisee's right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor's obligation arose. When all the promisee's rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights.

A right to the payment of money is frequently buttressed by ancillary covenants, such as covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, or covenants to preserve the creditworthiness of the promisor, such as covenants restricting dividends and the like. This article does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights.

Every "payment intangible" is also a "general intangible." Likewise, "software" is a "general intangible" for purposes of this article. See comment 25. Accordingly, except as otherwise provided, statutory provisions applicable to general intangibles apply to payment intangibles and software.

e. **"Letter-of-Credit Right."** The term "letter-of-credit right" embraces the rights to payment and performance under a letter of credit (defined in section 5-102). However, it does not include a beneficiary's right to demand payment or performance. Transfer of those rights to a transferee beneficiary is governed by article 5. See sections 9-107, comment 4, and 9-329, comments 3 and 4.

f. **"Supporting Obligation."** This new term covers the most common types of credit enhancements—suretyship obligations (including guarantees) and letter-of-credit rights that support one of the types of collateral specified in the definition. As explained in comment 2(a), suretyship law determines whether an obligation is "secondary" for purposes of this definition. Section 9-109 generally excludes from this article transfers of interests in insurance policies. However, the regulation of a secondary obligation as an insurance product does not necessarily mean that it is a "policy of insurance" for purposes of the exclusion in section 9-109. Thus, this article may cover a secondary obligation (as a supporting obligation), even if the obligation is issued by a regulated insurance company and the obligation is subject to regulation as an "insurance" product.

This article contains rules explicitly governing attachment, perfection, and priority of security interests in supporting obligations. See sections 9-203, 9-308, 9-310, and 9-322. These provisions reflect the principle that a supporting obligation is an incident of the collateral it supports.

Collections of or other distributions under a supporting obligation are "proceeds" of the supported collateral as well as "proceeds" of the supporting obligation itself. See section 9-102 (defining "proceeds") and comment 13(b). As such, the collections and distributions are subject to the priority rules applicable to proceeds generally. See section 9-322. However, under the special rule governing security interests in a letter-of-credit right, a secured party's failure to obtain control (section 9-107) of a letter-of-credit right supporting collateral may leave its security interest exposed to a priming interest of a party who does take control. See section 9-329 (security interest in a letter-of-credit right perfected by control has priority over a conflicting security interest).

g. **"Commercial Tort Claim."** This term is new. A tort claim may serve as original collateral under this article only if it is a "commercial tort claim." See section 9-109(d). Although security interests in commercial tort claims are within its scope, this article does not override other applicable law restricting the assignability of a tort claim. See section 9-401. A security interest in a tort claim also may exist under this article if the claim is proceeds of other collateral.

h. **"Account Debtor."** An "account debtor" is a person obligated on an account, chattel paper, or general intangible. The account debtor's obligation often is a monetary obligation; however, this is not always the case. For example, if a franchisee uses its rights under a franchise agreement (a general intangible) as collateral, then the franchisor is an "account debtor." As a general matter, article 3, and not article 9, governs obligations on negotiable instruments. Accordingly, the definition of "account debtor" excludes obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change from the definition in former article 9 is that the rules in sections 9-403, 9-404, 9-405, and 9-406, dealing with the rights of an assignee and duties of an account debtor, do not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. (Section 9-406(d), however, does apply to promissory notes, including negotiable promissory notes.) Rather, the assignee's rights are governed by article 3. Similarly, the duties of an obligor on a nonnegotiable instrument are governed by nonarticle 9 law unless the nonnegotiable instrument is a part of chattel paper, in which case the obligor is an account debtor.

i. **Receivables Under Government Entitlement Programs.** This article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of a right under a program, it could be an account, a payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g., crops).

6. **Investment-Property-Related Definitions: "Commodity Account"; "Commodity Contract"; "Commodity Customer"; "Commodity Intermediary"; "Investment Property."** These definitions are substantially the same as the corresponding definitions in former section 9-115. "Investment property" includes securities, both certificated and uncertificated, securities accounts, security entitlements, commodity accounts, and commodity contracts. The term investment property includes a "securities account" in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Former section 9-115 was added in conjunction with revised article 8 and contained a variety of rules applicable to security interests in investment property. These rules have been relocated to the appropriate sections of article 9. See, e.g., sections 9-203 (attachment), 9-314 (perfection by control), and 9-328 (priority).

The terms "security," "security entitlement," and related terms are defined in section 8-102, and the term "securities account" is defined in section 8-501. The terms "commodity account," "commodity contract," "commodity customer," and "commodity intermediary" are defined in this section. Commodity contracts are not "securities" or "financial assets" under article 8. See section 8-103(f). Thus, the relationship between commodity intermediaries and commodity customers is not governed by the indirect-holding-system rules of part 5 of article 8. For securities, article 9 contains rules on security interests, and article 8 contains rules on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful and gives rise to an adverse claim. For commodity contracts, article 9 establishes rules on security interests, but questions of the sort dealt with in article 8 for securities are left to other law.

The indirect-holding-system rules of article 8 are sufficiently flexible to be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the definition of "commodity contract" is narrowly drafted to ensure that it does not operate as an obstacle to the application of the article 8 indirect holding system rules to new products. The term "commodity contract" covers those contracts that are traded on or subject to the rules of a designated contract market and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that is excluded from article 8 but governed by article

9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodity Futures Trading Commission.

Commodity contracts are different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the commodity exchanges require that the contracts be marked to market on a daily basis; that is, the customer pays or receives any increment attributable to that day's price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire commodity account in which the borrower carries the hedging contracts, rather than in individual contracts.

One important effect of including commodity contracts and commodity accounts in article 9 is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer's positions in order to satisfy obligations of the customer to the futures commission merchant.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary's security interest in such securities is governed by the rules of this article on security interests in securities, not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and securities markets are closely linked. The rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The rules on security interests in investment property would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

7. **Consumer-Related Definitions: "Consumer Debtor"; "Consumer Goods"; "Consumer-goods transaction"; "Consumer Obligor"; "Consumer Transaction."** The definition of "consumer goods" (discussed above) is substantially the same as the definition in former section 9-109. The definitions of "consumer debtor," "consumer obligor," "consumer-goods transaction," and "consumer transaction" have been added in connection with various new (and old) consumer-related provisions and to designate certain provisions that are inapplicable in consumer transactions.

"Consumer-goods transaction" is a subset of "consumer transaction." Under each definition, both the obligation secured and the collateral must have a personal, family, or household purpose. However, "mixed" business and personal transactions also may be characterized as a consumer-goods transaction or consumer transaction. Subparagraph (A) of the definition of consumer-goods transactions and clause (i) of the definition of consumer transaction are primary purposes tests. Under these tests, it is necessary to determine the primary purpose of the obligation or obligations secured. Subparagraph (B) and clause (iii) of these definitions are satisfied if any of the collateral is consumer goods, in the case of a consumer-goods transaction, or "is held or acquired primarily for personal, family, or household purposes," in the case of a consumer transaction. The fact that some of the obligations secured or some of the collateral for the obligation does not satisfy the tests (e.g., some of the collateral is acquired for a business purpose) does not prevent a transaction from being a "consumer transaction" or "consumer-goods transaction."

8. **Filing-Related Definitions: "Continuation Statement"; "File Number"; "Filing Office"; "Filing-Office Rule"; "Financing Statement"; "Fixture Filing"; "Manufactured-Home Transaction"; "New Debtor"; "Original Debtor"; "Public-Finance Transaction"; "Termination Statement"; "Transmitting Utility."** These definitions are used exclusively or primarily in the filing-related provisions in Part 5. Most are self-explanatory and are discussed in the comments to Part 5. A financing statement filed in a manufactured-home transaction or a public-finance transaction may remain effective for 30 years instead of the 5 years applicable to other financing statements. See section 9-515(b). The definitions relating to medium neutrality also are significant for the filing provisions. See comment 9.

The definition of "transmitting utility" has been revised to embrace the business of transmitting communications generally to take account of new and future types of communications technology. The term designates a special class of debtors for whom separate filing rules are provided in part 5, thereby obviating the many local fixture filings that would be necessary under the rules of section 9-501 for a far-flung public-utility debtor. A transmitting utility will not necessarily be regulated by or operating as such in a jurisdiction where fixtures are located. For example, a utility might own transmission lines in a jurisdiction, although the utility generates no power and has no customers in the jurisdiction.

9. **Definitions Relating to Medium Neutrality.**

a. **"Record."** In many, but not all, instances, the term "record" replaces the term "writing" and "written." A "record" includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be "written," "in writing," or otherwise in tangible form do not necessarily reflect or aid commercial practices.

A "record" need not be permanent or indestructible, but the term does not include any oral or other communication that is not stored or preserved by any means. The information must be stored on paper or in some other medium. Information that has not been retained other than through human memory does not qualify as a record. Examples of current technologies commercially used to communicate or store information include, but are not limited to, magnetic media, optical discs, digital voice messaging systems, electronic mail, audio tapes, and photographic media, as well as paper. "Record" is an inclusive term that includes all of these methods of storing or communicating information. Any "writing" is a record. A record may be authenticated. See comment 9(b). A record may be created without the knowledge or intent of a particular person.

Like the terms "written" or "in writing," the term "record" does not establish the purposes, permitted uses, or legal effect that a record may have under any particular provision of law. Whatever is filed in the article 9 filing system, including financing statements, continuation statements, and termination statements, whether transmitted in tangible or intangible form, would fall within the definition. However, in some instances, statutes or filing-office rules may require that a paper record be filed. In such cases, even if this article permits the filing of an electronic record, compliance with those statutes or rules is necessary. Similarly, a filer must comply with a statute or rule that requires a particular type of encoding or formatting for an electronic record.

This article sometimes uses the terms "for record," "of record," "record or legal title," and "record owner." Some of these are terms traditionally used in real property law. The definition of "record" in this article now explicitly excepts these usages from the defined term. Also, this article refers to a record that is filed or recorded in real property recording systems to record a mortgage as a "record of a mortgage." This usage recognizes that the defined term "mortgage" means an interest in real property; it does not mean the record that evidences, or is filed or recorded with respect to, the mortgage.

b. **"Authenticate"; "Communicate"; "Send."** The terms "authenticate" and "authenticated" generally replace "sign" and "signed." "Authenticated" replaces and broadens the definition of "signed," in section 1-201, to encompass authentication of all records, not just writings. (References to authentication of, e.g., an agreement, demand, or notification mean, of course, authentication of a record containing an agreement, demand, or notification.) The terms "communicate" and "send" also contemplate the possibility of communication by nonwritten media. These definitions include the act of transmitting both tangible and intangible records. The definition of "send" replaces, for purposes of this article, the corresponding term in section 1-201. The reference to "usual means of communication" in that definition contemplates an inquiry into the appropriateness of the method of transmission used in the particular circumstances involved.

10. **Scope-Related Definitions.**

a. **Expanded Scope of Article: "Agricultural Lien"; "Consignment"; "Payment Intangible"; "Promissory Note."** These new definitions reflect the expanded scope of Article 9, as provided in section 9-109(a).

b. **Reduced Scope of Exclusions: "Governmental Unit"; "Health-Care-Insurance Receivable"; "Commercial Tort Claims."** These new definitions reflect the reduced scope of the exclusions, provided in section 9-109(c) and (d), of transfers by governmental debtors and assignments of interests in insurance policies and commercial tort claims.

11. **Choice-of-Law-Related Definitions: "Certificate of Title"; "Governmental Unit"; "Jurisdiction of Organization"; "Registered Organization"; "State."** These new definitions reflect the changes in the law governing perfection and priority of security interests and agricultural liens provided in Part 3, Subpart 1.

Not every organization that may provide information about itself in the public records is a "registered organization." For example, a general partnership is not a "registered organization," even if it files a statement of partnership authority under section 303 of the Uniform Partnership Act (1994) or an assumed name ("dba") certificate. This is because the state under whose law the partnership is organized is not required to maintain a public record showing that the partnership has been organized. In contrast, corporations, limited liability companies, and limited partnerships are "registered organizations."

12. **Deposit-Account-Related Definitions: "Deposit Account"; "Bank."** The revised definition of "deposit account" incorporates the definition of "bank," which is new. The definition derives from the definitions of "bank" in sections 4-105(1) and 4A-105(a)(2), which focus on whether the organization is "engaged in the business of banking."

Deposit accounts evidenced by article 9 "instruments" are excluded from the term "deposit account." In contrast, former section 9-105 excluded from the former definition "an account evidenced by a certificate of deposit." The revised definition clarifies the proper treatment of nonnegotiable or uncertificated certificates of deposit. Under the definition, an uncertificated certificate of deposit would be a deposit account (assuming there is no writing evidencing the bank's obligation to pay) whereas a nonnegotiable certificate of deposit would be a deposit account only if it is not an "instrument" as defined in this section (a question that turns on whether the nonnegotiable certificate of deposit is "of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment.")

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such an instrument cannot be perfected by "control" (see section 9-104), and the special priority rules applicable to deposit accounts (see sections 9-327 and 9-340) do not apply.

The term "deposit account" does not include "investment property," such as securities and security entitlements. Thus, the term also does not include shares in a money-market mutual fund, even if the shares are redeemable by check.

13. **Proceeds-Related Definitions: "Cash Proceeds"; "Noncash Proceeds"; "Proceeds."** The revised definition of "proceeds" expands the definition beyond that contained in former section 9-306 and resolves ambiguities in the former section.

a. **Distributions on Account of Collateral.** The phrase "whatever is collected on, or distributed on account of, collateral," in subparagraph (B), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. Compare former section 9-306 ("Any payments or distributions made with respect to investment property collateral are proceeds."). This section rejects the holding of Hastie v. FDIC, 2 F.3d 1042 (10th Cir. 1993) (postpetition cash dividends on stock subject to a prepetition pledge are not "proceeds" under Bankruptcy Code section 552(b)), to the extent the holding relies on the article 9 definition of "proceeds."

b. **Distributions on Account of Supporting Obligations.** Under subparagraph (B), collections on and distributions on account of collateral consisting of various credit-support arrangements ("supporting obligations," as defined in section 9-102) also are proceeds. Consequently, they are afforded treatment identical to proceeds collected from or distributed by the obligor on the underlying (supported) right to payment or other collateral. Proceeds of supporting obligations also are proceeds of the underlying rights to payment or other collateral.

c. **Proceeds of Proceeds.** The definition of "proceeds" no longer provides that proceeds of proceeds are themselves proceeds. That idea is expressed in the revised definition of "collateral" in section 9-102. No change in meaning is intended.

d. **Proceeds Received by Person Who Did Not Create Security Interest.** When collateral is sold subject to a security interest and the buyer then resells the collateral, a question arose under former article 9 concerning whether the "debtor" had "received" what the buyer received on resale and, therefore, whether those receipts were "proceeds" under former section 9-306(2). This article contains no requirement that property be "received" by the debtor for the property to qualify as proceeds. It is necessary only that the property be traceable, directly or indirectly, to the original collateral.

e. **Cash Proceeds and Noncash Proceeds.** The definition of "cash proceeds" is substantially the same as the corresponding definition in former section 9-306. The phrase "and the like" covers property that is functionally equivalent to "money, checks, or deposit accounts," such as some money market accounts that are securities or part of securities entitlements. Proceeds other than cash proceeds are noncash proceeds.

14. **Consignment-Related Definitions: "Consignee"; "Consignment"; "Consignor."** The definition of "consignment" excludes, in subparagraphs (B) and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. A consignment excluded from the application of this article by one of those subparagraphs may still be a true consignment; however, it is governed by nonarticle 9 law. The definition also excludes, in subparagraph (D), what have been called "consignments intended for security." These "consignments" are not bailments but secured transactions. Accordingly, all of article 9 applies to them. See sections 1-201(37) and 9-109(a)(1). The "consignor" is the person who delivers goods to the "consignee" in a consignment.

The definition of "consignment" requires that the goods be delivered "to a merchant for the purpose of sale." If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of the delivery is "sale." On the other hand, if a merchant-processor-bailee will not be selling the goods itself but will be delivering to buyers to which the owner-bailor agreed to sell the goods, the transaction would not be a consignment.

15. **"Accounting."** This definition describes the record and information that a debtor is entitled to request under section 9-210.

16. **"Document."** The definition of "document" is unchanged in substance from the corresponding definitions in former section 9-105. See section 1-201(15) and comment 15.

17. **"Encumbrance"; "Mortgage."** The definitions of "encumbrance" and "mortgage" are unchanged in substance from the corresponding definitions in former section 9-105. They are used primarily in the special real-property-related priority and other provisions relating to crops, fixtures, and accessions.

18. **"Fixtures."** This definition is unchanged in substance from the corresponding definition in former section 9-313. See section 9-334 (priority of security interests in fixtures and crops).

19. **"Good Faith."** This article expands the definition of "good faith" to include "the observance of reasonable commercial standards of fair dealing." The definition in this section applies when the term is used in this article, and the same concept applies in the context of this article for purposes of the obligation of good faith imposed by section 1-203. See subsection (c).

20. **"Lien Creditor."** This definition is unchanged in substance from the corresponding definition in former section 9-301.

21. **"New Value."** This article deletes former section 9-108. Its broad formulation of new value, which embraced the taking of after-acquired collateral for a pre-existing claim, was unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after-acquired collateral from attack as a voidable preference in bankruptcy. The new definition derives from Bankruptcy Code section 547(a). The term is used with respect to temporary perfection of security interests in instruments, certificated securities, or negotiable documents under section 9-312(e) and with respect to chattel paper priority in section 9-330.

22. **"Person Related To."** Section 9-615 provides a special method for calculating a deficiency or surplus when "the secured party, a person related to the secured party, or a secondary obligor" acquires the collateral at a foreclosure disposition. Separate definitions of the term are provided with respect to an individual secured party and with respect to a secured party that is an organization. The definitions are patterned on the corresponding definition in section 1.301(32) of the Uniform Consumer Credit Code (1974).

23. **"Proposal."** This definition describes a record that is sufficient to propose to retain collateral in full or partial satisfaction of a secured obligation. See sections 9-620, 9-621, and 9-622.

24. **"Pursuant to Commitment."** This definition is unchanged in substance from the corresponding definition in former section 9-105. It is used in connection with special priority rules applicable to future advances. See section 9-323.

25. **"Software."** The definition of "software" is used in connection with the priority rules applicable to purchase-money security interests. See sections 9-103 and 9-324. Software, like a payment intangible, is a type of general intangible for purposes of this article. See Comment 4.a., above, regarding the distinction between "goods" and "software."

26. **Terminology: "Assignment" and "Transfer."** In numerous provisions, this article refers to the "assignment" or the "transfer" of property interests. These terms and their

derivatives are not defined. This article generally follows common usage by using the terms "assignment" and "assign" to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term "transfer" to refer to other transfers of interests in property. Except when used in connection with a letter-of-credit transaction (see section 9-107, comment 4), no significance should be placed on the use of one term or the other. Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest.

NORTH CAROLINA COMMENT

Clause (ii) of subdivision (a)(45) has no counterpart in the uniform text. Subdivisions (a)(65), (66), and (67) were adapted from the uniform text's optional model provisions for production-money priority. Subdivision (a)(67) is modified by adding "curing."

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, ss. 21 and 44, effective October 1, 2006, repealed subdivision (a)(43), which read: "'Good faith' means honesty in fact and the observance of reasonable commercial standards of fair dealing."; substituted "G.S. 25-7-201(b)" for "G.S. 25-7-201(2)" in subdivision (a)(30); in subsection (b), added "'Control' as provided in G.S. 25-7-106 and" at the beginning of the introductory language and inserted "'Issuer' (with respect to documents of title) G.S. 25-7-102." in the list of definitions in other articles.

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Guarantor Is Not a Debtor. — The definition of the term "debtor" under this section does not include guarantors. Community Bank & Trust Co. v. Copses, 953 F.2d 133 (4th Cir. 1991).

"Secured party" is not synonymous with "titleholder" and holding title was not a prerequisite to being a secured party within the context of former G.S. 25-9-505(1). Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Husband Was Secured Party Although Title Was in Wife's Name. — Trial court did not commit error by treating husband as converter of motor vehicle even though the repossessed vehicle was titled in his wife's name only; where record revealed that defendant husband negotiated with plaintiff throughout the financial transaction regarding the sale of the vehicle, represented to plaintiff that the vehicle's transmission was in good condition, signed the sales agreement conveying truck to plaintiff, and completed repossession forms with the Department of Motor Vehicles, husband was a party to the sales agreement which created a security interest in the vehicle, and therefore was subject to the provisions of former G.S. 25-9-505 pertaining to compulsory disposition of collateral. Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

"Security Agreement". — Any written agreement signed by a debtor which recites that certain personalty is being encumbered as security for a debt ought to operate as a security agreement. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

"Instrument". — In light of the prevailing commercial practices and the purpose of the Uniform Commercial Code, there is no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

"General Intangible". — Debtors' interest in unearned portion of a retainer paid to a law firm was a general intangible; as such, a creditor with a properly perfected security interest had a lien on the balance of the retainer fund; in reaching its determination that the retainer was a general intangible, the bankruptcy court reasoned that the debtors' interest in the retainer was neither a deposit account (because the law firm was not a bank or financial institution) or "money" (because the debtors had only the right to receive a refund on the unearned portion of the retainer fund) and therefore, the interest was a general intangible. In re E-Z Serve Convenience Stores, Inc., 299 B.R. 126, 2003 Bankr. LEXIS 1358 (Bankr. M.D.N.C. 2003), aff'd, 318 Bankr. 637 (M.D.N.C. 2004).

Some Grant of Security Interest Required. — A reading of the definition of "security agreement" in this section suggests that some grant of a security interest is required. Evans v. Everett, 10 N.C. App. 435, 179 S.E.2d 120, rev'd on other grounds, 279 N.C. 352, 183 S.E.2d 109 (1971).

Maker of a note secured by a deed of trust was obligated to make payments to possessor of the note and deed of trust until the note was paid in full. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Security interest in a mobile home which was moveable, tangible property, was governed by Article 9 of the UCC. Section 41-2.5(a), which provides that when a husband and wife become co-owners of a mobile home, in the absence of anything to the contrary appearing in the instrument of title, they become tenants by the entirety with all the incidents of an estate by the entirety in real property, did not dictate a contrary result. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Priority of Security Interests in Bankrupt's Equipment. — In an action to determine which of two creditors was entitled to money in trustee's possession resulting from the sale of the debtor's boat, the evidence supported the contention that the corporate debtor's boat was purchased by the bankrupt corporation, used by it and was to be considered "equipment" of the bankrupt rather than "consumer goods," so that under former G.S. 25-9-312, the security interest of the first secured creditor in all present and future equipment owned by the bankrupt took priority over the security interest of the second creditor which was perfected more than 10 days after the bankrupt took possession of the boat. In re Boiling Springs Constr. Co., 3 Bankr. 251 (Bankr. E.D.N.C. 1980).

Agreement That Items Affixed to House Remained Personalty Did Not Bind Third Parties. — While the contract provided that the windows and gutters which were affixed to the house remained personal property, and such an agreement may be valid between the parties to the contract, it is not binding when third parties become involved. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

Bound Volumes Held "Inventory". — Where the buyer was engaged in the business of microfilming books, journals, records, and other like material, and in buying and selling both microfilm records and printed material, the bound volumes sold to the buyer were "inventory," and not "equipment." First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850, cert. denied, 278 N.C. 703, 181 S.E.2d 601 (1971).

A mobile home is a consumer good. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Financing Statement Not Required. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Obligations Owner Who Was Not Debtor. — Former G.S. 25-9-112, relating to situations where collateral was not owned by the debtor, expanded on the definition of former G.S. 25-9-105 by describing the secured party's obligations to an owner of collateral who was not the debtor. Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005); In re Augusta Tissue Mill, LLC, — Bankr. —, 2007 Bankr. LEXIS 3040 (Bankr. M.D.N.C. Sept. 5, 2007).

§ 25-9-103. Purchase-money security interest; application of payments; burden of establishing.

(a) Definitions. — In this section:

(1) "Purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(2) "Purchase-money obligation" means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(b) Purchase-money security interest in goods. — A security interest in goods is a purchase-money security interest:

(1) To the extent that the goods are purchase-money collateral with respect to that security interest;

(2) If the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(3) Also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(c) Purchase-money security interest in software. — A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(1) The debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(2) The debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(d) Consignor's inventory purchase-money security interest. — The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(e) Application of payment in non-consumer-goods transaction. — In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) In accordance with any reasonable method of application to which the parties agree;

(2) In the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) In the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

a. To obligations that are not secured; and

b. If more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(f) No loss of status of purchase-money security interest in non-consumer-goods transaction. — In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(1) The purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(2) Collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(3) The purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

(g) Burden of proof in non-consumer-goods transaction. — In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(h) Non-consumer-goods transactions; no inference. — The limitation of the rules in subsections (e), (f), and (g) of this section to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1993, c. 370, s. 1; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-107.

2. **Scope of This Section.** Under section 9-309(1), a purchase-money security interest in consumer goods is perfected when it attaches. Sections 9-317 and 9-324 provide special priority rules for purchase-money security interests in a variety of contexts. This section explains when a security interest enjoys purchase-money status.

3. **"Purchase-Money Collateral"; "Purchase-Money Obligation"; "Purchase-Money Security Interest."** Subsection (a) defines "purchase-money collateral" and "purchase-money obligation." These terms are essential to the description of what constitutes a purchase-money security interest under subsection (b). As used in subsection (a)(2), the definition of "purchase-money obligation," the "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.

4. **Cross-Collateralization of Purchase-Money Security Interests in Inventory.** Subsection (b)(2) deals with the problem of cross-collateralized purchase-money security interests in inventory. Consider a simple example:

Example: Seller (S) sells an item of inventory (Item-1) to Debtor (D), retaining a security interest in Item-1 to secure Item-1's price and all other obligations, existing and future, of D to S. S then sells another item of inventory to D (Item-2), again retaining a security interest in Item-2 to secure Item-2's price as well as all other obligations of D to S. D then pays to S Item-1's price. D then sells Item-2 to a buyer in ordinary course of business, who takes Item-2 free of S's security interest.

Under subsection (b)(2), S's security interest in *Item-1* securing *Item-2's unpaid price* would be a purchase-money security interest. This is so because S has a purchase-money security interest in Item-1, Item-1 secures the price of (a "purchase-money obligation incurred with respect to") Item-2 ("other inventory"), and Item-2 itself was subject to a purchase-money security interest. Note that, to the extent Item-1 secures the price of Item-2, S's security interest in Item-1 would not be a purchase-money security interest under subsection (b)(1). The security interest in Item-1 is a purchase-money security interest under subsection (b)(1) only to the extent that Item-1 is "purchase-money collateral," i.e., only to the extent that Item-1 "secures a purchase-money obligation incurred with respect to that collateral" (i.e., Item-1). See subsection (a)(1).

5. **Purchase-Money Security Interests in Goods and Software.** Subsections (b) and (c) limit purchase-money security interests to security interests in goods, including fixtures, and software. Otherwise, no change in meaning from former section 9-107 is intended. The second sentence of former section 9-115(5)(f) made the purchase-money priority rule (former section 9-312(4)) inapplicable to investment property. This section's limitation makes that provision unnecessary.

Subsection (c) describes the limited circumstances under which a security interest in goods may be accompanied by a purchase-money security interest in software. The software must be acquired by the debtor in a transaction integrated with the transaction in which the debtor acquired the goods, and the debtor must acquire the software for the principal purpose of using the software in the goods. "Software" is defined in section 9-102.

6. **Consignments.** Under former section 9-114, the priority of the consignor's interest is similar to that of a purchase-money security interest. Subsection (d) achieves this result more directly, by defining the interest of a "consignor," defined in section 9-102, to be a purchase-money security interest in inventory for purposes of this article. This drafting convention obviates any need to set forth special priority rules applicable to the interest of a consignor. Rather, the priority of the consignor's interest as against the rights of lien creditors of the consignee, competing secured parties, and purchasers of the goods from the consignee can be determined by reference to the priority rules generally applicable to inventory, such as sections 9-317, 9-320, 9-322, and 9-324. For other purposes, including the rights and duties of the consignor and consignee as between themselves, the consignor would remain the owner of goods under a bailment arrangement with the consignee. See Section 9-319.

7. **Provisions Applicable Only to Non-Consumer-Goods Transactions.**

a. **"Dual-Status" Rule.** For transactions other than consumer-goods transactions, this article approves what some cases have called the "dual-status" rule, under which a security interest may be a purchase-money security interest to some extent and a nonpurchase-money security interest to some extent. (Concerning consumer-goods transactions, see subsection (h) and comment 8.) Some courts have found this rule to be explicit or implicit in the words "to the extent," found in former section 9-107 and continued in subsections (b)(1) and (b)(2). The rule is made explicit in subsection (e). For nonconsumer-goods transactions, this article rejects the "transformation" rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely.

Consider, for example, what happens when a $10,000 loan secured by a purchase-money security interest is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional $2,000 secured by the collateral. Subsection (f) resolves any doubt that the security interest remains a purchase-money security interest. Under subsection (b), however, it enjoys purchase-money status only to the extent of $10,000.

b. **Allocation of Payments.** Continuing with the example, if the debtor makes a $1,000 payment on the $12,000 obligation, then one must determine the extent to which the security interest remains a purchase-money security interest $9,000 or $10,000. Subsection (e)(1) expresses the overriding principle, applicable in cases other than consumer-goods transactions, for determining the extent to which a security interest is a purchase-money security interest under these circumstances: Freedom of contract, as limited by principle of reasonableness. An unconscionable method of application, for example, is not a reasonable one and so would not be given effect under subsection (e)(1). In the absence of agreement, subsection (e)(2) permits the obligor to determine how payments should be allocated. If the obligor fails to manifest its intention, obligations that are not secured will be paid first. (As used in this article, the concept of "obligations that are not secured" means obligations for which the debtor has not created a security interest. This concept is different from and should not be confused with the concept of an "unsecured claim" as it appears in Bankruptcy Code section 506(a).) The obligor may prefer this approach, because unsecured debt is likely to carry a higher interest rate than secured debt. A creditor who would prefer to be secured rather than unsecured also would prefer this approach.

After the unsecured debt is paid, payments are to be applied first toward the obligations secured by purchase-money security interests. In the event that there is more than one such obligation, payments first received are to be applied to obligations first incurred. See subsection (e)(3). Once these obligations are paid, there are no purchase-money security interests and no additional allocation rules are needed.

Subsection (f) buttresses the dual-status rule by making it clear that (in a transaction other than a consumer-goods transaction) cross-collateralization and renewals, refinancings, and restructurings do not cause a purchase-money security interest to lose its status as such. The statutory terms "renewed," "refinanced," and "restructured" are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that an identifiable portion of the purchase-money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring.

c. **Burden of Proof.** As is the case when the extent of a security interest is in issue, under subsection (g) the secured party claiming a purchase-money security interest in a transaction other than a consumer-goods transaction has the burden of establishing whether the security interest retains its purchase-money status. This is so whether the determination is to be made following a renewal, refinancing, or restructuring or otherwise.

8. **Consumer-Goods Transactions; Characterization Under Other Law.** Under subsection (h), the limitation of subsections (e), (f), and (g) to transactions other than consumer-goods transactions leaves to the court the determination of the proper rules in consumer-goods transactions. Subsection (h) also instructs the court not to draw any inference from this limitation as to the proper rules for consumer-goods transactions and leaves the court free to continue to apply established approaches to those transactions.

This section addresses only whether a security interest is a "purchase-money security interest" under this article, primarily for purposes of perfection and priority. See, e.g., sections 9-317 and 9-324. In particular, its adoption of the dual-status rule, allocation of payments rules, and burden of proof standards for non-consumer-goods transactions is not intended to affect or influence characterizations under other statutes. Whether a security interest is a "purchase-money security interest" under other law is determined by that law. For example, decisions under Bankruptcy Code section 522(f) have applied both the dual-status and the transformation rules. The Bankruptcy Code does not expressly adopt the state law definition of "purchase-money security interest." Where federal law does not defer to this article, this article does not, and could not, determine a question of federal law.

Legal Periodicals. — For comment, "'Refinanced or Modified': Is it a PMSI? An Analysis of North Carolina's PMSI Amendment," see 29 Wake Forest L. Rev. 915 (1994).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Consolidation of Loans Did Not Destroy Security Interest. — Consolidation of three loan agreements by creditor did not destroy its purchase money security interest in the tools it sold to the debtors. In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

As to when consignor was required to file under former Article 9, see BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Where a bank had no notice of a loan collateral sale that a bankruptcy court consented to allow, the bank could collaterally attack the consent order; as the bank had priority with a superior interest in the collateral, it was entitled to summary judgment over the company who sold the collateral. First-Citizens Bank & Trust Co. v. Four Oaks Bank & Trust Co., 156 N.C. App. 378, 576 S.E.2d 722, 2003 N.C. App. LEXIS 127 (2003).

§ 25-9-103.1. Production-money crops; production-money obligation; production-money security interest; burden of establishing.

(a) Production-money crops. — A security interest in crops is a production-money security interest to the extent that the crops are production-money crops.

(b) Production-money obligation. — If the extent to which a security interest is a production-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) In accordance with any reasonable method of application to which the parties agree;

(2) In the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) In the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

   a. To obligations that are not secured; and

b. If more than one obligation is secured, to obligations secured by production-money security interests in the order in which those obligations were incurred.

(c) Production-money security interest. — A production-money security interest does not lose its status as such, even if:

(1) The production-money crops also secure an obligation that is not a production-money obligation;

(2) Collateral that is not production-money crops also secures the production-money obligation; or

(3) The production-money obligation has been renewed, refinanced, or restructured.

(d) Burden of proof. — A secured party claiming a production-money security interest has the burden of establishing the extent to which the security interest is a production-money security interest. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1; 1967, c. 24, s. 13; 1975, c. 862, s. 7; 1979, c. 404, s. 2; 1989 (Reg. Sess., 1990), c. 1024, s. 8(o); 1997-181, ss. 15, 16; 1997-336, s. 1; 1997-456, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Production-Money Priority; "Production-Money Security Interest."** This section is patterned closely on Section 9-103, which defines "purchase-money security interest." Subsection (b) makes clear that a security interest can obtain production-money status only to the extent that it secures value that actually can be traced to the direct production of crops. To the extent that a security interest secures indirect costs of production, such as general living expenses, the security interest is not entitled to production-money treatment.

NORTH CAROLINA COMMENT

This section was adapted from the uniform text's optional model provisions for production-money priority.

§ 25-9-104. Control of deposit account.

(a) Requirements for control. — A secured party has control of a deposit account if:

(1) The secured party is the bank with which the deposit account is maintained;

(2) The debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or

(3) The secured party becomes the bank's customer with respect to the deposit account.

(b) Debtor's right to direct disposition. — A secured party that has satisfied subsection (a) of this section has control, even if the debtor retains the right to direct the disposition of funds from the deposit account. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1999-73, s. 5(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; derived from section 8-106.

2. **Why "Control" Matters.** This section explains the concept of "control" of a deposit account. "Control" under this section may serve

two functions. First, "control . . . pursuant to the debtor's agreement" may substitute for an authenticated security agreement as an element of attachment. See section 9-203(b)(3)(D). Second, when a deposit account is taken as original collateral, the only method of perfection is obtaining control under this section. See section 9-312(b)(1).

3. **Requirements for "Control."** This section derives from section 8-106 of revised article 8, which defines "control" of securities and certain other investment property. Under subsection (a)(1), the bank with which the deposit account is maintained has control. The effect of this provision is to afford the bank automatic perfection. No other form of public notice is necessary; all actual and potential creditors of the debtor are always on notice that the bank with which the debtor's deposit account is maintained may assert a claim against the deposit account.

Under subsection (a)(2), a secured party may obtain control by obtaining the bank's authenticated agreement that it will comply with the secured party's instructions without further consent by the debtor. The analogous provision in section 8-106 does not require that the agreement be authenticated. An agreement to comply with the secured party's instructions suffices for "control" of a deposit account under this section even if the bank's agreement is subject to specified conditions, e.g., that the secured party's instructions are accompanied by a certification that the debtor is in default. (Of course, if the condition is the *debtor's* further consent, the statute explicitly provides that the agreement would *not* confer control.) See revised section 8-106, comment 7.

Under subsection (a)(3), a secured party may obtain control by becoming the bank's "customer," as defined in section 4-104. As the customer, the secured party would enjoy the right (but not necessarily the exclusive right) to withdraw funds from, or close, the deposit account. See sections 4-401(a) and 4-403(a).

Although the arrangements giving rise to control may themselves prevent, or may enable the secured party at its discretion to prevent, the debtor from reaching the funds on deposit, subsection (b) makes clear that the debtor's ability to reach the funds is not inconsistent with "control."

Perfection by control is not available for bank accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are "instruments" and not "deposit accounts." See section 9-102 (defining "deposit account" and "instrument").

§ 25-9-105. Control of electronic chattel paper.

A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in subdivisions (4), (5), and (6) of this section, unalterable;

(2) The authoritative copy identifies the secured party as the assignee of the record or records;

(3) The authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(g); 1997-181, s. 3; 1997-456, s. 4; 1999-73, s. 6; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **"Control" of Electronic Chattel Paper.** This article covers security interests in "electronic chattel paper," a new term defined in section 9-102. This section governs how "control" of electronic chattel paper may be obtained. A secured party's control of electronic chattel paper (i) may substitute for an authenticated security agreement for purposes of attachment under section 9-203, (ii) is a method of perfection under section 9-314, and (iii) is a condition for obtaining special, nontemporal

priority under section 9-330. Because electronic chattel paper cannot be transferred, assigned, or possessed in the same manner as tangible chattel paper, a special definition of control is necessary. In descriptive terms, this section provides that control of electronic chattel paper is the functional equivalent of possession of "tangible chattel paper" (a term also defined in section 9-102).

3. **"Authoritative Copy" of Electronic Chattel Paper.** One requirement for establishing control is that a particular copy be an "authoritative copy." Although other copies may exist, they must be distinguished from the authoritative copy. This may be achieved, for example, through the methods of authentication that are used or by business practices involving the marking of any additional copies. When tangible chattel paper is converted to electronic chattel paper, in order to establish that a copy of the electronic chattel paper is the authoritative copy it may be necessary to show that the tangible chattel paper no longer exists or has been permanently marked to indicate that it is not the authoritative copy.

4. **Development of Control Systems.** This article leaves to the marketplace the development of systems and procedures, through a combination of suitable technologies and business practices, for dealing with control of electronic chattel paper in a commercial context. However, achieving control under this section requires more than the agreement of interested persons that the elements of control are satisfied. For example, paragraph (4) contemplates that control requires that it be a physical impossibility (or sufficiently unlikely or implausible so as to approach practical impossibility) to add or change an identified assignee without the participation of the secured party (or its authorized representative). It would not be enough for the assignor merely to agree that it will not change the identified assignee without the assignee-secured party's consent. However, the standards applied to determine whether a party is in control of electronic chattel paper should not be more stringent than the standards now applied to determine whether a party is in possession of tangible chattel paper. Control of electronic chattel paper contemplates systems or procedures such that the secured party must take some action (either directly or through its designated custodian) to effect a change or addition to the authoritative copy. But just as a secured party does not lose possession of tangible chattel paper merely by virtue of the possibility that a person acting on its behalf *could* wrongfully redeliver the chattel paper to the debtor, so control of electronic chattel paper would not be defeated by the possibility that the secured party's interest *could* be subverted by the wrongful conduct of a person (such as a custodian) acting on its behalf.

Systems that evolve for control of electronic chattel paper may or may not involve a third party custodian of the relevant records. However, this section and the concept of control of electronic chattel paper are not based on the same concepts as are control of deposit accounts (section 9-104), security entitlements, a type of investment property (section 9-106), and letter-of-credit rights (section 9-107). The rules for control of that collateral are based on existing market practices and legal and regulatory regimes for institutions such as banks and securities intermediaries. Analogous practices for electronic chattel paper are developing nonetheless. The flexible approach adopted by this section, moreover, should not impede the development of these practices and, eventually, legal and regulatory regimes, which may become analogous to those for, e.g., investment property.

§ 25-9-106. Control of investment property.

(a) Control under G.S. 25-8-106. — A person has control of a certificated security, uncertificated security, or security entitlement as provided in G.S. 25-8-106.

(b) Control of commodity contract. — A secured party has control of a commodity contract if:

(1) The secured party is the commodity intermediary with which the commodity contract is carried; or

(2) The commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) Effect of control of securities account or commodity account. — A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account. (1945, c. 196, s. 1; 1957, c. 504; 1965,

c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1997-181, s. 4; 1999-73, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-115(e).

2. **"Control" Under Article 8.** For an explanation of "control" of securities and certain other investment property, see section 8-106, comments 4 and 7.

3. **"Control" of Commodity Contracts.** This section, as did former section 9-115(1)(e), contains provisions relating to control of commodity contracts which are analogous to those in section 8-106 for other types of investment property.

4. **Securities Accounts and Commodity Accounts.** For drafting convenience, control with respect to a securities account or commodity account is defined in terms of obtaining control over the security entitlements or commodity contracts. Of course, an agreement that provides that (without further consent of the debtor) the securities intermediary or commodity intermediary will honor instructions from the secured party concerning a securities account or commodity account described as such is sufficient. Such an agreement necessarily implies that the intermediary will honor instructions concerning all security entitlements or commodity contracts carried in the account and thus affords the secured party control of all the security entitlements or commodity contracts.

§ 25-9-107. Control of letter-of-credit right.

A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under G.S. 25-5-114(c) or otherwise applicable law or practice. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1993, c. 370, s. 1; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **"Control" of Letter-of-Credit Right.** Whether a secured party has control of a letter-of-credit right may determine the secured party's priority as against competing secured parties. See section 9-329. This section provides that a secured party acquires control of a letter-of-credit right by receiving an assignment if the secured party obtains the consent of the issuer or any nominated person, such as a confirmer or negotiating bank, under section 5-114 or other applicable law or practice. Because both issuers and nominated persons may give or be obligated to give value under a letter of credit, this section contemplates that a secured party obtains control of a letter-of-credit right with respect to the issuer or a particular nominated person only to the extent that the issuer or that nominated person consents to the assignment. For example, if a secured party obtains control to the extent of an issuer's obligation but fails to obtain the consent of a nominated person, the secured party does not have control to the extent that the nominated person gives value. In many cases the person or persons who will give value under a letter of credit will be clear from its terms. In other cases, prudence may suggest obtaining consent from more than one person. The details of the consenting issuer's or nominated person's duties to pay or otherwise render performance to the secured party are left to the agreement of the parties.

3. **"Proceeds of a Letter of Credit."** Section 5-114 follows traditional banking terminology by referring to a letter of credit beneficiary's assignment of its right to receive payment thereunder as an assignment of the "proceeds of a letter of credit." However, as the seller of goods can assign its right to receive payment (an "account") before it has been earned by delivering the goods to the buyer, so the beneficiary of a letter of credit can assign its contingent right to payment before the letter of credit has been honored. See section 5-114(b). If the assignment creates a security interest, the security interest can be perfected at the time it is created. An assignment of, including the creation of a security interest in, a letter-of-credit right is an assignment of a present interest.

4. **"Transfer" vs. "Assignment."** Letter-of-credit law and practice distinguish the "transfer" of a letter of credit from an "assignment." Under a transfer, the transferee itself becomes the beneficiary and acquires the right to draw. Whether a new, substitute credit is issued or the issuer advises the transferee of its status as such, the transfer constitutes a novation under which the transferee is the new, substituted beneficiary (but only to the extent of the transfer, in the case of a partial transfer).

Section 5-114(e) provides that the rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds. For this reason, transfer does not appear in this article as a means of control or perfection. Section 9-109(c)(4) recognizes the independent and superior rights of a transferee beneficiary under section 5-114(e); this article does not apply to the rights of a transferee beneficiary or nominated person to the extent that those rights are independent and superior under section 5-114.

5. **Supporting Obligation: Automatic Attachment and Perfection.** A letter-of-credit right is a type of "supporting obligation," as defined in section 9-102. Under sections 9-203 and 9-308, a security interest in a letter-of-credit right automatically attaches and is automatically perfected if the security interest in the supported obligation is a perfected security interest. However, unless the secured party has control of the letter-of-credit right or itself becomes a transferee beneficiary, it cannot obtain any rights against the issuer or a nominated person under article 5. Consequently, as a practical matter, the secured party's rights would be limited to its ability to locate and identify proceeds distributed by the issuer or nominated person under the letter of credit.

§ 25-9-108. Sufficiency of description.

(a) Sufficiency of description. — Except as otherwise provided in subsections (c), (d), and (e) of this section, a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) Examples of reasonable identification. — Except as otherwise provided in subsection (d) of this section, a description of collateral reasonably identifies the collateral if it identifies the collateral by:

(1) Specific listing;
(2) Category;
(3) Except as otherwise provided in subsection (e) of this section, a type of collateral defined in this Chapter;
(4) Quantity;
(5) Computational or allocational formula or procedure; or
(6) Except as otherwise provided in subsection (c) of this section, any other method, if the identity of the collateral is objectively determinable.

(c) Supergeneric description not sufficient. — A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.

(d) Investment property. — Except as otherwise provided in subsection (e) of this section, a description of a security entitlement, securities account, or commodity account is sufficient if it describes:

(1) The collateral by those terms or as investment property; or
(2) The underlying financial asset or commodity contract.

(e) When description by type insufficient. — A description only by type of collateral defined in this Chapter is an insufficient description of:

(1) A commercial tort claim; or
(2) In a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-110 and 9-115(3).

2. **General Rules.** Subsection (a) retains substantially the same formulation as former section 9-110. Subsection (b) expands upon subsection (a) by indicating a variety of ways in which a description might reasonably identify collateral. Whereas a provision similar to subsection (b) was applicable only to investment property under former section 9-115(3), subsection (b) applies to all types of collateral, subject to the limitation in subsection (d). Subsection (b) is subject to subsection (c), which follows prevailing case law and adopts the view that an

"all assets" or "all personal property" description for purposes of a *security agreement* is *not* sufficient. Note, however, that under section 9-504, a *financing statement* sufficiently indicates the collateral if it "covers all assets or all personal property."

The purpose of requiring a description of collateral in a security agreement under section 9-203 is evidentiary. The test of sufficiency of a description under this section, as under former section 9-110, is that the description do the job assigned to it: Make possible the identification of the collateral described. This section rejects any requirement that a description is insufficient unless it is exact and detailed (the so-called "serial number" test).

3. **After-Acquired Collateral.** Much litigation has arisen over whether a description in a security agreement is sufficient to include after-acquired collateral if the agreement does not explicitly so provide. This question is one of contract interpretation and is not susceptible to a statutory rule (other than a rule to the effect that it is a question of contract interpretation). Accordingly, this section contains no reference to descriptions of after-acquired collateral.

4. **Investment Property.** Under subsection (d), the use of the wrong article 8 terminology does not render a description invalid (e.g., a security agreement intended to cover a debtor's "security entitlements" is sufficient if it refers to the debtor's "securities"). Note also that given the broad definition of "securities account" in section 8-501, a security interest in a securities account also includes all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement. Moreover, describing collateral as a securities account is a simple way of describing all of the security entitlements carried in the account.

5. **Consumer Investment Property; Commercial Tort Claims.** Subsection (e) requires greater specificity of description in order to prevent debtors from inadvertently encumbering certain property. Subsection (e) requires that a description by defined "type" of collateral alone of a commercial tort claim or, in a consumer transaction, of a security entitlement, securities account, or commodity account, is not sufficient. For example, "all existing and after-acquired investment property" or "all existing and after-acquired security entitlements," without more, would be insufficient in a consumer transaction to describe a security entitlement, securities account, or commodity account. The reference to "*only* by type" in subsection (e) means that a description is sufficient if it satisfies subsection (a) and contains a descriptive component beyond the "type" alone. Moreover, if the collateral consists of a securities account or commodity account, a description of the account is sufficient to cover all existing and future security entitlements or commodity contracts carried in the account. See section 9-203(h) and (i).

Under section 9-204, an after-acquired collateral clause in a security agreement will not reach future commercial tort claims. It follows that when an effective security agreement covering a commercial tort claim is entered into the claim already will exist. Subsection (e) does not require a description to be specific. For example, a description such as "all tort claims arising out of the explosion of debtor's factory" would suffice, even if the exact amount of the claim, the theory on which it may be based, and the identity of the tortfeasor(s) are not described. (Indeed, those facts may not be known at the time.)

CASE NOTES

***Editor's Note.** — The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

A description of real estate is sufficient if the description permits identification of the land involved by recourse to public records. E-B Grain Co. v. Denton, 73 N.C. App. 14, 325 S.E.2d 522, cert. denied, 313 N.C. 598, 330 S.E.2d 608 (1985).

Description Held Sufficient. — Where the security agreement described the collateral as all dairy cattle proceeds and accounts receivable resulting from milk sales and the site of the farm, this description reasonably identified the collateral. Mountain Farm Credit Serv. v. Purina Mills, Inc., 119 N.C. App. 508, 459 S.E.2d 75 (1995).

In an action regarding the purchase and sale of a business, in which the sellers counterclaimed on a promissory note executed by the buyer, the evidence showed that the security agreement was signed and proper, value was given through the transaction, and the buyer took possession of the collateral, so a valid security interest was created and had attached to the collateral, under G.S. 25-9-203(1), and the property was sufficiently described, as it only needed to be reasonably identified by the agreement, under G.S. 25-9-108. Kindred of N.C., Inc. v. Bond, 160 N.C. App. 90, 584 S.E.2d 846, 2003 N.C. App. LEXIS 1765 (2003).

As to the sufficiency of land descriptions for agricultural liens, see Gwathney v. Etheridge, 99 N.C. 571, 6 S.E. 411 (1888); Weil v. Flowers, 109 N.C. 212, 13 S.E. 761 (1891); Crinkley v. Egerton, 113 N.C. 142, 18 S.E. 341 (1893), decided under former statutory provisions.

Subpart 2. Applicability of Article.

§ 25-9-109. Scope.

(a) General scope of Article. — Except as otherwise provided in subsections (c) and (d) of this section, this Article applies to:

(1) A transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) An agricultural lien;

(3) A sale of accounts, chattel paper, payment intangibles, or promissory notes;

(4) A consignment;

(5) A security interest arising under G.S. 25-2-401, 25-2-505, 25-2-711(3), or 25-2A-508(5), as provided in G.S. 25-9-110; and

(6) A security interest arising under G.S. 25-4-208 or G.S. 25-5-118.

(b) Security interest in secured obligation. — The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

(c) Extent to which Article does not apply. — This Article does not apply to the extent that:

(1) A statute, regulation, or treaty of the United States preempts this Article;

(2) Repealed by Session Laws 2001-218, s. 2, effective July 1, 2001.

(3) A statute of another state, a foreign country, or a governmental unit of another state or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit; or

(4) The rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under G.S. 25-5-114.

(d) Inapplicability of Article. — This Article does not apply to:

(1) A landlord's lien, other than an agricultural lien;

(2) A lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but G.S. 25-9-333 applies with respect to priority of the lien;

(3) An assignment of a claim for wages, salary, or other compensation of an employee;

(4) A sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;

(5) An assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(6) An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(7) An assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(8) A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but G.S. 25-9-315 and G.S. 25-9-322 apply with respect to proceeds and priorities in proceeds;

(9) An assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;
(10) A right of recoupment or setoff, but:
  a. G.S. 25-9-340 applies with respect to the effectiveness of rights of recoupment or setoff against deposit accounts; and
  b. G.S. 25-9-404 applies with respect to defenses or claims of an account debtor;
(11) The creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:
  a. Liens on real property in G.S. 25-9-203 and G.S. 25-9-308;
  b. Fixtures in G.S. 25-9-334;
  c. Fixture filings in G.S. 25-9-501, 25-9-502, 25-9-512, 25-9-516, and 25-9-519; and
  d. Security agreements covering personal and real property in G.S. 25-9-604;
(12) An assignment of a claim arising in tort, other than a commercial tort claim, but G.S. 25-9-315 and G.S. 25-9-322 apply with respect to proceeds and priorities in proceeds;
(13) An assignment of a deposit account in a consumer transaction, but G.S. 25-9-315 and G.S. 25-9-322 apply with respect to proceeds and priorities in proceeds; or
(14) The creation, perfection, priority, or enforcement of any lien on, assignment of, pledge of, or security in, any revenues, rights, funds, or other tangible or intangible assets created, made, or granted by this State or a governmental unit in this State, including the assignment of rights as secured party in security interests granted by any party subject to the provisions of this Article to this State or a governmental unit in this State, to secure, directly or indirectly, any bond, note, other evidence of indebtedness, or other payment obligations for borrowed money issued by, or in connection with, installment or lease purchase financings by, this State or a governmental unit in this State. However, notwithstanding this subdivision, this Article does apply to the creation, perfection, priority, and enforcement of security interests created by this State or a governmental unit in this State in equipment or fixtures. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1; 2001-218, s. 2.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-102 and 9-104.

2. **Basic Scope Provision.** Subsection (a)(1) derives from former section 9-102(1) and (2). These subsections have been combined and shortened. No change in meaning is intended. Under subsection (a)(1), all consensual security interests in personal property and fixtures are covered by this article, except for transactions excluded by subsections (c) and (d). As to which transactions give rise to a "security interest," the definition of that term in section 1-201 must be consulted. When a security interest is created, this article applies regardless of the form of the transaction or the name that parties have given to it.

3. **Agricultural Liens.** Subsection (a)(2) is new. It expands the scope of this article to cover agricultural liens, as defined in section 9-102.

4. **Sales of Accounts, Chattel Paper, Payment Intangibles, Promissory Notes, and Other Receivables.** Under subsection (a)(3), as under former section 9-102, this article applies to sales of accounts and chattel paper. This approach generally has been successful in avoiding difficult problems of distinguishing between transactions in which a receivable secures an obligation and those in which the receivable has been sold outright. In many commercial financing transactions the distinction is blurred.

Subsection (a)(3) expands the scope of this article by including the sale of a "payment intangible" (defined in section 9-102 as "a general intangible under which the account debtor's principal obligation is a monetary obligation") and a "promissory note" (also defined in section 9-102). To a considerable extent, this article affords these transactions treatment identical to that given sales of accounts and chattel paper. In some respects, however, sales of payment intangibles and promissory notes are treated differently from sales of other receivables. See, e.g., sections 9-309 (automatic perfection upon attachment) and 9-408 (effect of restrictions on assignment). By virtue of the expanded definition of "account" (defined in section 9-102), this article now covers sales of (and other security interests in) "health-care-insurance receivables" (also defined in section 9-102). Although this article occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither this article nor the definition of "security interest" (section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts.

5. **Transfer of Ownership in Sales of Receivables.** A "sale" of an account, chattel paper, a promissory note, or a payment intangible includes a sale of a right in the receivable, such as a sale of a participation interest. The term also includes the sale of an enforcement right. For example, a "(p)erson entitled to enforce" a negotiable promissory note (section 3-301) may sell its ownership rights in the instrument. See section 3-203, comment 1 ("Ownership rights in instruments may be determined by principles of the law of property, independent of article 3, which do not depend upon whether the instrument was transferred under section 3-203."). Also, the right under section 3-309 to enforce a lost, destroyed, or stolen negotiable promissory note may be sold to a purchaser who could enforce that right by causing the seller to provide the proof required under that section. This article rejects decisions reaching a contrary result, e.g., *Dennis Joslin Co. v. Robinson Broadcasting*, 977 F.Supp. 491 (D.D.C. 1997).

Nothing in this section or any other provision of article 9 prevents the transfer of full and complete ownership of an account, chattel paper, an instrument, or a payment intangible in a transaction of sale. However, as mentioned in comment 4, neither this article nor the definition of "security interest" in section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation. This article applies to both types of transactions. The principal effect of this coverage is to apply this article's perfection and priority rules to these sales transactions. Use of terminology such as "security interest," "debtor," and "collateral" is merely a drafting convention adopted to reach this end, and its use has no relevance to distinguishing sales from other transactions. See PEB Commentary No. 14.

Following a debtor's outright sale and transfer of ownership of a receivable, the debtor-seller retains no legal or equitable rights in the receivable that has been sold. See section 9-318(a). This is so whether or not the buyer's security interest is perfected. (A security interest arising from the sale of a promissory note or payment intangible is perfected upon attachment without further action. See section 9-309.) However, if the buyer's interest in accounts or chattel paper is unperfected, a subsequent lien creditor, perfected secured party, or qualified buyer can reach the sold receivable and achieve priority over (or take free of) the buyer's unperfected security interest under section 9-317. This is so not because the seller of a receivable retains rights in the property sold; it does not. Nor is this so because the seller of a receivable is a "debtor" and the buyer of a receivable is a "secured party" under this article (they are). It is so for the simple reason that sections 9-317, 9-318(b), and 9-322 make it so, as did former sections 9-301 and 9-312. Because the buyer's security interest is unperfected, for purposes of determining the rights of creditors of and purchasers for value from the debtor-seller, under section 9-318(b) the debtor-seller is deemed to have the rights and title it sold. Section 9-317 subjects the buyer's unperfected interest in accounts and chattel paper to that of the debtor-seller's lien creditor and other persons who qualify under that section.

6. **Consignments.** Subsection (a)(4) is new. This article applies to every "consignment." The term, defined in section 9-102, includes many but not all "true" consignments (i.e., bailments for the purpose of sale). If a transaction is a "sale or return," as defined in revised section 2-326, it is not a "consignment." In a "sale or return" transaction, the buyer becomes the owner of the goods, and the seller may obtain an enforceable security interest in the goods only by satisfying the requirements of section 9-203.

Under common law, creditors of a bailee were unable to reach the interest of the bailor (in the case of a consignment, the consignor-owner). Like former section 2-326 and former article 9, this article changes the common law result; however, it does so in a different manner. For purposes of determining the rights and interests of third-party creditors of, and purchasers of the goods from, the consignee, but not for other purposes, such as remedies of the consignor, the consignee is deemed to acquire under this article whatever rights and title the consignor had or had power to transfer. See section 9-319. The interest of a consignor is defined to be a security interest under revised section 1-201(37), more specifically, a purchase-money security interest in the consignee's inventory. See section 9-103(d). Thus, the rules pertaining to lien creditors, buyers, and attachment, perfection, and priority of competing security interests apply to consigned goods. The relationship between the consignor and consignee is left to other law. Consignors also have no duties under part 6. See section 9-601(g).

Sometimes parties characterize transactions that secure an obligation (other than the bailee's obligation to returned bailed goods) as "consignments." These transactions are not "consignments" as contemplated by section 9-109(a)(4). See section 9-102. This article applies also to these transactions, by virtue of section 9-109(a)(1). They create a security interest within the meaning of the first sentence of section 1-201(37).

This article does not apply to bailments for sale that fall outside the definition of "consignment" in section 9-102 and that do not create a security interest that secures an obligation.

7. **Security Interest in Obligation Secured by Nonarticle 9 Transaction.** Subsection (b) is unchanged in substance from former section 9-102(3). The following example provides an illustration.

Example 1: O borrows $10,000 from M and secures its repayment obligation, evidenced by a promissory note, by granting to M a mortgage on O's land. This article does not apply to the creation of the real property mortgage. However, if M sells the promissory note to X or gives a security interest in the note to secure M's own obligation to X, this article applies to the security interest thereby created in favor of X. The security interest in the promissory note is covered by this article even though the note is secured by a real property mortgage. Also, X's security interest in the note gives X an attached security interest in the mortgage lien that secures the note and, if the security interest in the note is perfected, the security interest in the mortgage lien likewise is perfected. See sections 9-203 and 9-308.

It also follows from subsection (b) that an attempt to obtain or perfect a security interest in a secured obligation by complying with nonarticle 9 law, as by an assignment of record of a real property mortgage, would be ineffective. Finally, it is implicit from subsection (b) that one cannot obtain a security interest in a lien, such as a mortgage on real property, that is not also coupled with an equally effective security interest in the secured obligation. This article rejects cases such as In re *Maryville Savings & Loan Corp.*, 743 F.2d 413 (6th Cir. 1984), clarified on reconsideration, 760 F.2d 119 (1985).

8. **Federal Preemption.** Former section 9-104(a) excluded from article 9 "a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." Some (erroneously) read the former section to suggest that article 9 sometimes deferred to federal law even when federal law did not preempt article 9. Subsection (c)(1) recognizes explicitly that this article defers to federal law only when and to the extent that it must—i.e., when federal law preempts it.

9. **Governmental Debtors.** Former section 9-104(e) excluded transfers by governmental debtors. It has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c). These paragraphs reflect the view that article 9 should apply to security interests created by a state, foreign country, or a "governmental unit" (defined in section 9-102) of either except to the extent that another statute governs the issue in question. Under paragraph (2), this article defers to all statutes of the forum state. (A forum cannot determine whether it should consult the choice of law rules in the forum's UCC unless it first determines that its UCC applies to the transaction before it.) Paragraph (3) defers to statutes of another state or a foreign country only to the extent that those statutes contain rules applicable specifically to security interests created by the governmental unit in question.

Example 2: A New Jersey state commission creates a security interest in favor of a New York bank. The validity of the security interest is litigated in New York. The relevant security agreement provides that it is governed by New York law. To the extent that a New Jersey statute contains rules peculiar to creation of security interests by governmental units generally, to creation of security interests by state commissions, or to creation of security interests by this particular state commission, then that law will govern. On the other hand, to the extent that New Jersey law provides that security interests created by governmental units, state commissions, or this state commission are governed by the law generally applicable to secured transactions (i.e., New Jersey's article 9), then New York's article 9 will govern.

Example 3: An airline that is an instrumentality of a foreign country creates a security interest in favor of a New York bank. The analysis used in the previous example would apply here. That is, if the matter is litigated in New York, New York law would govern except to the extent that the foreign country enacted a statute applicable to security interests created by governmental units generally or by the airline specifically.

The fact that New York law applies does not necessarily mean that perfection is accomplished by filing in New York. Rather, it means that the court should apply New York's article 9, including its choice of law provisions. Under New York's section 9-301, perfection is governed by the law of the jurisdiction in which the debtor is located. Section 9-307 determines the debtor's location for choice of law purposes.

If a transaction does not bear an appropriate relation to the forum state, then that state's article 9 will not apply, regardless of whether the transaction would be excluded by paragraph (3).

Example 4: A Belgian governmental unit grants a security interest in its equipment to a Swiss secured party. The equipment is located in Belgium. A dispute arises and, for some reason, an action is brought in a New Mexico state court. Inasmuch as the transaction bears no "appropriate relation" to New Mexico, New Mexico's UCC, including its article 9, is inapplicable. See section 1-105(1). New Mexico's section 9-109(c) on excluded transactions should not come into play. Even if the parties agreed that New Mexico law would govern, the parties' agreement would not be effective because the transaction does not bear a "reasonable relation" to New Mexico. See section 1-105(1).

Conversely, article 9 will come into play only if the litigation arises in a UCC jurisdiction or if a foreign choice of law rule leads a foreign court to apply the law of a UCC jurisdiction. For example, if issues concerning a security interest granted by a foreign airline to a New York bank are litigated overseas, the court may be bound to apply the law of the debtor's jurisdiction and not New York's article 9.

10. **Certain Statutory and Common-Law Liens; Interests in Real Property.** With few exceptions (nonconsensual agricultural liens being one), this article applies only to consensual security interests in personal property. Following former section 9-104(b) and (j), paragraphs (1) and (11) of subsection (d) exclude landlord's liens and leases and most other interests in or liens on real property. These exclusions generally reiterate the limitations on coverage (i.e., "by contract," "in personal property and fixtures") made explicit in subsection (a)(1). Similarly, most jurisdictions provide special liens to suppliers of many types of services and materials, either by statute or by common law. With the exception of agricultural liens, it is not necessary for this article to provide general codification of this lien structure, which is determined in large part by local conditions and which is far removed from ordinary commercial financing. As under former section 9-104(c), subsection (d)(2) excludes these suppliers' liens (other than agricultural liens) from this article. However, section 9-333 provides a rule for determining priorities between certain possessory suppliers' liens and security interests covered by this article.

11. **Wage and Similar Claims.** As under former section 9-104(d), subsection (d)(3) excludes assignments of claims for wages and the like from this article. These assignments present important social issues that other law addresses. The Federal Trade Commission has ruled that, with some exceptions, the taking of an assignment of wages or other earnings is an unfair act or practice under the Federal Trade Commission Act. See 16 C.F.R. part 444. State statutes also may regulate such assignments.

12. **Certain Sales and Assignments of Receivables; Judgments.** In general this article covers security interests in (including sales of) accounts, chattel paper, payment intangibles, and promissory notes. Paragraphs (4), (5), (6), and (7) of subsection (d) exclude from the article certain sales and assignments of receivables that, by their nature, do not concern commercial financing transactions. These paragraphs add to the exclusions in former section 9-104(f) analogous sales and assignments of payment intangibles and promissory notes. For similar reasons, subsection (d)(9) retains the exclusion of assignments of judgments under former section 9-104(h) (other than judgments taken on a right to payment that itself was collateral under this article).

13. **Insurance.** Subsection (d)(8) narrows somewhat the broad exclusion of interests in insurance policies under former section 9-104(g). This article now covers assignments by or to a health-care provider of "health-care-insurance receivables" (defined in section 9-102).

14. **Set-Off.** Subsection (d)(10) adds two exceptions to the general exclusion of set-off rights from article 9 under former section 9-104(i). The first takes account of new section 9-340, which regulates the effectiveness of a set-off against a deposit account that stands as collateral. The second recognizes section 9-404, which affords the obligor on an account, chattel paper, or general intangible the right to raise claims and defenses against an assignee (secured party).

15. **Tort Claims.** Subsection (d)(12) narrows somewhat the broad exclusion of transfers of tort claims under former section 9-104(k). This article now applies to assignments of "commercial tort claims" (defined in section 9-102) as well as to security interests in tort claims that constitute proceeds of other collateral (e.g., a right to payment for negligent destruction of the debtor's inventory). Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and ceases to be a claim arising in tort.

This article contains two special rules governing creation of a security interest in tort claims. First, a description of collateral in a security agreement as "all tort claims" is insufficient to meet the requirement for attachment. See section 9-108(e). Second, no security interest attaches under an after-acquired property clause to a tort claim. See section 9-204(b). In addition, this article does not determine whom the tortfeasor must pay to discharge its obligation. Inasmuch as a tortfeasor is not an "account debtor," the rules governing waiver of defenses and discharge of an obligation by an obligor (sections 9-403, 9-404, 9-405, and 9-406) are inapplicable to tort claim collateral.

16. **Deposit Accounts.** Except in consumer transactions, deposit accounts may be taken as original collateral under this article. Under former section 9-104(l), deposit accounts were excluded as original collateral, leaving security interests in deposit accounts to be governed by the common law. The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter. By excluding deposit accounts from the article's scope as original collateral in consumer transactions, subsection (d)(13) leaves those transactions to law other than this article. However, in both consumer and nonconsumer transactions, sections 9-315 and 9-322 apply to deposit accounts as proceeds and with respect to priorities in proceeds.

This article contains several safeguards to protect debtors against inadvertently encumbering deposit accounts and to reduce the likelihood that a secured party will realize a windfall from a debtor's deposit accounts. For example, because "deposit account" is a separate type of collateral, a security agreement covering general intangibles will not adequately describe deposit accounts. Rather, a security agreement must reasonably identify the deposit accounts that are the subject of a security interest, e.g., by using the term "deposit accounts." See section 9-108. To perfect a security interest in a deposit account as original collateral, a secured party (other than the bank with which the deposit account is maintained) must obtain "control" of the account either by obtaining the bank's authenticated agreement or by becoming the bank's customer with respect to the deposit account. See sections 9-104 and 9-312(b)(1). Either of these steps requires the debtor's consent.

This article also contains new rules that determine which state's law governs perfection and priority of a security interest in a deposit account (section 9-304), priority of conflicting security interests in and set-off rights against a deposit account (sections 9-327 and 9-340), the rights of transferees of funds from an encumbered deposit account (section 9-332), the obligations of the bank (section 9-341), enforcement of security interests in a deposit account (section 9-607(c)), and the duty of a secured party to terminate control of a deposit account (section 9-208(b)).

NORTH CAROLINA COMMENT

Subdivision (c)(2) of the uniform text is omitted. Subdivision (d)(14) has no counterpart in the uniform text.

The State, units of local government, and special authorities and agencies thereof are authorized by applicable law to issue bonds and other obligations and evidences of indebtedness secured by pledges of revenues and other identified sources of funds available to the issuer to pay the obligations. The statutes authorizing the issuance of these bonds and other obligations and evidences of indebtedness customarily authorize the issuer to pledge these revenues and other sources of funds and provide for the perfection, priority, and enforceability of the pledge (see, e.g., G.S. 122A-10, G.S. 131A-13, G.S. 159-47, G.S. 159-91, G.S. 159B-17, G.S. 159C-12, and G.S. 159I-30(b)). Generally, these statutory provisions provide that a first lien on the pledged revenues or other resources (and the right to receive the same) is created at the time the pledge is made, and that no other action is necessary to perfect the pledge. Therefore, the creation, perfection, priority, and enforcement of a security interest arising from the pledge of those revenues and other sources of funds are excepted from this Article in its entirety.

In contrast, in certain transactions the State or unit of local government or special authorities or agencies thereof may enter into transactions in which a security interest in equipment or fixtures is given to secure bonds or other obligations or evidences of indebtedness (see, e.g., G.S. 160A-20). In those instances, generally there are not specific statutory provisions addressing the procedures for the creation, perfection, priority, and enforcement of the security interest created. This Article applies to security interests created in equipment and fixtures in those transactions. This Article is not intended to be an independent authorization for the creation of security interests by the State or any governmental unit. To the extent that the original security interest is not created in equipment and fixtures, the exception from application of this Article described in the second paragraph hereof would apply.

The exception from application of this Article applies only to security interests granted by governmental units (as defined in G.S. 25-9-102(45)). In some "conduit" financings (such as under Chapter 131A or Chapter 159C of the General Statutes), a nongovernmental unit may grant a security interest in various collateral to secure its obligations to the governmental unit incurred in connection with the financing transaction. The security interest may be assigned by the governmental unit to a corporate trustee or similar entity to secure bonds or other obligations issued by the governmental unit. Under these circumstances, the security interest created by a nongovernmental unit to secure obligations to the governmental unit is subject to this Article, while the assignment of rights by the governmental unit in that security interest to secure the bonds or bother obligations of the governmental unit is not subject to this Article regardless of the type of collateral being assigned. In addition, if a governmental unit grants a security interest in equipment or fixtures to another governmental unit, the assignment of rights as secured party by the governmental unit is not subject to this Article.

Cross References. — As to inapplicability of Article 9 to any security interest created in connection with the issuance of bonds under G.S. 115C-513, see G.S. 115C-513(b).

Legal Periodicals. — For article concerning liens on personal property not governed by the UCC, see 44 N.C.L. Rev. 322 (1966).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For note on the non-purchase security agreement as a relinquishment of the personal property exemption, see 15 Wake Forest L. Rev. 708 (1979).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Applicability of Article 9. — This Article applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Article 9 does not apply where collateral consists of unearned insurance premiums. In re Universal Motor Express, Inc., 72 Bankr. 208 (Bankr. W.D.N.C. 1987).

Security Interest Replaces Chattel Mortgages. — An Article 9 security interest by the terms of the Uniform Commercial Code replaces the older chattel mortgage as a method of protecting the creditor. Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219, appeal dismissed, 295 N.C. 551, 248 S.E.2d 727 (1978).

Security interest in a mobile home which was moveable, tangible property, was governed by Article 9 of the UCC. Section 41-2.5(a), which provides that when a husband and wife become co-owners of a mobile home, in the absence of anything to the contrary appearing in the instrument of title, they become tenants by the entirety with all the incidents of an estate by the entirety in real property, did not dictate a contrary result. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Sale of Collateral. — When a creditor which had contracted with an auctioneer to sell a defaulting debtor's collateral transferred its rights to another, which entered into a second contract with the auctioneer, the fact that the second contract was less favorable than the first to a guarantor's rights against the debtor did not render its terms commercially unreasonable, under G.S. 25-9-109, G.S. 25-9-615(a)(1), or G.S. 25-9-610(b), because there was sufficient evidence that a presumptively reasonable public sale was held, and the guarantor did not have standing as an intended third-party beneficiary of the first contract to enforce it. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

The phrase "landlord's lien" is construed to refer to liens created by statute. A detailed reading of this section (the section excluding certain types of transactions from the Code) in its entirety, together with the comments of the National Conference of Commissioners of Uniform State Laws, indicates that all of the other subsections deal with matters thought to be sufficiently covered by a statute of the United States or of the several states or that they deal with special transactions which do not fit easily into general commercial statute and which are adequately covered by existing law. From this viewpoint it also appears that the term "landlord's lien" as used in the statute must be interpreted as referring to liens created by statute, for the matter of liens on property is obviously considered by all of the remainder of the Code as fitting into a general commercial statute. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

This section's exclusion of landlord's liens is not applicable to consensual liens. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

A lien on personal property granted a lessor by contract is not excluded from the provisions of the UCC. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

Agricultural Lien on Soybeans. — Section 44-69.1, which was excluded from Article 9 prior to its revision by Session Laws 2000-169, specifically controls the legal duration of an agricultural lien upon soybeans under state substantive law and is not a statute of limitations. United States v. Bailey Feed Mill, Inc., 592 F. Supp. 844 (E.D.N.C. 1984).

Landlord's Lien Had Priority Under Former Agricultural Lien Act. — See Ballard & Co. v. Johnson, 114 N.C. 141, 19 S.E. 98 (1894); Williams v. Davis, 183 N.C. 90, 110 S.E. 577 (1922); Montague v. Thorpe, 196 N.C. 163, 144 S.E. 691 (1928); Rhodes v. Smith-Douglass Fertilizer Co., 220 N.C. 21, 16 S.E.2d 408 (1941).

Right of Setoff. — Former G.S. 25-9-104(i), which specifically excluded any right of setoff from Article 9 of the UCC, merely removed the right of setoff from the filing and perfection requirements of Article 9 and did not affect the applicability of the Article's priority rules when a security interest was involved. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

§ 25-9-110. Security interests arising under Article 2 or 2A of this Chapter.

A security interest arising under G.S. 25-2-401, 25-2-505, 25-2-711(3), or 25-2A-508(5) is subject to this Article. However, until the debtor obtains possession of the goods:

(1) The security interest is enforceable, even if G.S. 25-9-203(b)(3) has not been satisfied;
(2) Filing is not required to perfect the security interest;
(3) The rights of the secured party after default by the debtor are governed by Article 2 or 2A of this Chapter; and
(4) The security interest has priority over a conflicting security interest created by the debtor. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1993, c. 463, s. 3; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-113.

2. **Background.** Former section 9-113, from which this section derives, referred generally to security interests "arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A)." Views differed as to the precise scope of that section. In contrast, section 9-110 specifies the security interests to which it applies.

3. **Security Interests Under Articles 2 and 2A.** Section 2-505 explains how a seller of goods may reserve a security interest in them. Section 2-401 indicates that a reservation of title by the seller of goods, despite delivery to the buyer, is limited to reservation of a security interest. As did former article 9, this article governs a security interest arising solely under one of those sections; however, until the buyer obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the seller-secured party's rights on the buyer's default are governed by article 2.

Sections 2-711(3) and 2A-508(5) create a security interest in favor of a buyer or lessee in possession of goods that were rightfully rejected or as to which acceptance was justifiably revoked. As did former article 9, this article governs a security interest arising solely under one of those sections; however, until the seller or lessor obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the secured party's (buyer's or lessee's) rights on the debtor's (seller's or lessor's) default are governed by article 2 or 2A, as the case may be.

4. **Priority.** This section adds to former section 9-113 a priority rule. Until the debtor obtains possession of the goods, a security interest arising under one of the specified sections of article 2 or 2A has priority over conflicting security interests created by the debtor. Thus, a security interest arising under section 2-401 or 2-505 has priority over a conflicting security interest in the buyer's after-acquired goods, even if the goods in question are inventory. Arguably, the same result would obtain under section 9-322, but even if it would not, a purchase-money-like priority is appropriate. Similarly, a security interest under section 2-711(3) or 2A-508(5) has priority over security interests claimed by the seller's or lessor's secured lender. This result is appropriate, inasmuch as the payments giving rise to the debt secured by the article 2 or 2A security interest are likely to be included among the lender's proceeds.

Example: Seller owns equipment subject to a security interest created by Seller in favor of Lender. Buyer pays for the equipment, accepts the goods, and then justifiably revokes acceptance. As long as Seller does not recover possession of the equipment, Buyer's security interest under section 2-711(3) is senior to that of Lender.

In the event that a security interest referred to in this section conflicts with a security interest that is created by a person other than the debtor, section 9-325 applies. Thus, if Lender's security interest in the example was created not by Seller but by the person from whom Seller acquired the goods, section 9-325 would govern.

5. **Relationship to Other Rights and Remedies Under Articles 2 and 2A.** This article does not specifically address the conflict between (i) a security interest created by a buyer or lessee and (ii) the seller's or lessor's right to withhold delivery under section 2-702(1), 2-703(a), or 2A-525, the seller's or lessor's right to stop delivery under section 2-705 or 2A-526, or the seller's right to reclaim under section 2-507(2) or 2-702(2). These conflicts are governed by the first sentence of section 2-403(1), under which the buyer's secured party obtains no greater rights in the goods than the buyer had or had power to convey, or section 2A-307(1), under which creditors of the lessee take subject to the lease contract.

PART 2.

Effectiveness of Security Agreement; Attachment of Security Interest; Rights of Parties to Security Agreement.

Subpart 1. Effectiveness and Attachment.

§ 25-9-201. General effectiveness of security agreement.

(a) General effectiveness. — Except as otherwise provided in this Chapter, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(b) Applicable consumer laws and other law. — A transaction subject to this Article is subject to any applicable rule of law which establishes a different rule for consumers, to any other statute, rule, or regulation of this State that regulates the rates, charges, agreements, and practices for loans, credit sales, or other extensions of credit, and to any consumer-protection statute, rule, or regulation of this State, including Chapter 24 of the General Statutes, the Retail Installment Sales Act (Chapter 25A of the General Statutes), the North Carolina Consumer Finance Act (Article 15 of Chapter 53 of the General Statutes), and the Pawnbrokers Modernization Act of 1989 (Chapter 91A of the General Statutes).

(c) Other applicable law controls. — In case of conflict between this Article and a rule of law, statute, or regulation described in subsection (b) of this section, the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subsection (b) of this section has only the effect the statute or regulation specifies.

(d) Further deference to other applicable law. — This Article does not:

(1) Validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subsection (b) of this section; or
(2) Extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-201 and 9-203(4).

2. **Effectiveness of Security Agreement.** Subsection (a) provides that a security agreement is generally effective. With certain exceptions, a security agreement is effective between the debtor and secured party and is likewise effective against third parties. Note that "security agreement" is used here (and elsewhere in this article) as it is defined in section 9-102: "(A)n agreement that creates or provides for a security interest." It follows that subsection (a) does not provide that every term or provision contained in a record that contains a security agreement or that is so labeled is effective. Properly read, former section 9-201 was to the same effect. Exceptions to the general rule of subsection (a) arise where there is an overriding provision in this article or any other article of the UCC. For example, section 9-317 subordinates unperfected security interests to lien creditors and certain buyers, and several provisions in part 3 subordinate some security interests to other security interests and interests of purchasers.

3. **Law, Statutes, and Regulations Applicable to Certain Transactions.** Subsection (b) makes clear that certain transactions, although subject to this article, also are subject to other applicable laws relating to consumers or specified in that subsection. Subsection (c) provides that the other law is controlling in the event of a conflict, and that a violation of other law does not *ipso facto* constitute a violation of this article. Subsection (d) provides that this article does not validate violations under or extend the application of the other applicable laws.

Legal Periodicals. — For comment on usury law in North Carolina, see 47 N.C.L. Rev. 761 (1969).

For article, "Certainty, Efficiency, and Realism: Rights in Collateral Under Article 9 of the Uniform Commercial Code," see 73 N.C.L. Rev. 115 (1994).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Priority of Perfected Security Interest. — Bank's perfected security interest in debtor's peanut crop had priority over the right of setoff of the peanut company created subsequent thereto, whereby the company furnished peanut seed to debtors in exchange for their agreement to convey a quantity of matured peanuts to the company. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

Compliance with statute was necessary to sustain agricultural lien. Clark v. Farrar, 74 N.C. 686 (1876); Reese & Co. v. Cole, 93 N.C. 87 (1885).

Instrument May Give Remedy Different from Statute. — A power of sale upon default in paying advances, inserted in an instrument, giving a lien upon crops, does not invalidate the instrument, though prescribing a different remedy from that allowed by the statute. Crinkley v. Egerton, 113 N.C. 142, 18 S.E. 341 (1893).

Instrument held valid both as chattel mortgage and agricultural lien. Nichols & Bros. v. Speller, 120 N.C. 75, 26 S.E. 632 (1897).

§ 25-9-202. Title to collateral immaterial.

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this Article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-202.

2. **Title Immaterial.** The rights and duties of parties to a secured transaction and affected third parties are provided in this article without reference to the location of "title" to the collateral. For example, the characteristics of a security interest that secures the purchase price of goods are the same whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed title or a lien to the secured party.

3. **When Title Matters.**

a. **Under This Article.** This section explicitly acknowledges two circumstances in which the effect of certain article 9 provisions turns on ownership (title). First, in some respects sales of accounts, chattel paper, payment intangibles, and promissory notes receive special treatment. See, e.g., sections 9-207(a), 9-210(b), and 9-615(e). Buyers of receivables under former article 9 were treated specially, as well. See, e.g., former section 9-502(2). Second, the remedies of a consignor under a true consignment and, for the most part, the remedies of a buyer of accounts, chattel paper, payment intangibles, or promissory notes are determined by other law and not by part 6. See section 9-601(g).

b. **Under Other Law.** This article does not determine which line of interpretation (e.g., title theory or lien theory, retained title or conveyed title) should be followed in cases in which the applicability of another rule of law depends upon who has title. If, for example, a revenue law imposes a tax on the "legal" owner of goods or if a corporation law makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determines the location and source of title for those purposes.

Legal Periodicals. — For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Applicability of Article 9. — This Article applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

§ 25-9-203. Attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites.

(a) Attachment. — A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(b) Enforceability. — Except as otherwise provided in subsections (c) through (i) of this section, a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(1) Value has been given;
(2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
(3) One of the following conditions is met:
  a. The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

b. The collateral is not a certificated security and is in the possession of the secured party under G.S. 25-9-313 pursuant to the debtor's security agreement;

c. The collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under G.S. 25-8-301 pursuant to the debtor's security agreement; or

d. The collateral is deposit accounts, electronic chattel paper, investment property, letter-of-credit rights, or electronic documents, and the secured party has control under G.S. 25-7-106, 25-9-104, 25-9-105, 25-9-106, or 25-9-107 pursuant to the debtor's security agreement.

(c) Other UCC provisions. — Subsection (b) of this section is subject to G.S. 25-4-208 on the security interest of a collecting bank, G.S. 25-5-118 on the security interest of a letter-of-credit issuer or nominated person, G.S. 25-9-110 on a security interest arising under Article 2 or 2A of this Chapter, and G.S. 25-9-206 on security interests in investment property.

(d) When person becomes bound by another person's security agreement. — A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this Article or by contract:

(1) The security agreement becomes effective to create a security interest in the person's property; or

(2) The person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(e) Effect of new debtor becoming bound. — If a new debtor becomes bound as debtor by a security agreement entered into by another person:

(1) The agreement satisfies subdivision (b)(3) of this section with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and

(2) Another agreement is not necessary to make a security interest in the property enforceable.

(f) Proceeds and supporting obligations. — The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by G.S. 25-9-315 and is also attachment of a security interest in a supporting obligation for the collateral.

(g) Lien securing right to payment. — The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

(h) Security entitlement carried in securities account. — The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(i) Commodity contracts carried in commodity account. — The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account. (1997-181, s. 5; 2000-169, s. 1; 2006-112, s. 45.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-115(2), (6) and 9-203.

2. **Creation, Attachment, and Enforceability.** Subsection (a) states the general rule that a security interest attaches to collateral only when it becomes enforceable against the debtor. Subsection (b) specifies the circumstances under which a security interest becomes enforceable. Subsection (b) states three basic prerequisites to the existence of a security interest: Value (paragraph (1)), rights or power to transfer rights in collateral (paragraph (2)), and agreement plus satisfaction of an evidentiary requirement (paragraph (3)). When all of

these elements exist, a security interest becomes enforceable between the parties and attaches under subsection (a). Subsection (c) identifies certain exceptions to the general rule of subsection (b).

3. **Security Agreement; Authentication.** Under subsection (b)(3), enforceability requires the debtor's security agreement and compliance with an evidentiary requirement in the nature of a statute of frauds. Paragraph (3)(A) represents the most basic of the evidentiary alternatives, under which the debtor must authenticate a security agreement that provides a description of the collateral. Under section 9-102, a "security agreement" is "an agreement that creates or provides for a security interest." Neither that definition nor the requirement of paragraph (3)(A) rejects the deeply rooted doctrine that a bill of sale, although absolute in form, may be shown in fact to have been given as security. Under this article, as under prior law, a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security. Similarly, a self-styled "lease" may serve as a security agreement if the agreement creates a security interest. See section 1-201(37) (distinguishing security interest from lease).

4. **Possession, Delivery, or Control Pursuant to Security Agreement.** The other alternatives in subsection (b)(3) dispense with the requirement of an authenticated security agreement and provide alternative evidentiary tests. Under paragraph (3)(B), the secured party's possession substitutes for the debtor's authentication under paragraph (3)(A) if the secured party's possession is "pursuant to the debtor's security agreement." That phrase refers to the debtor's agreement to the secured party's possession for the purpose of creating a security interest. The phrase should not be confused with the phrase "debtor has authenticated a security agreement," used in paragraph (3)(A), which contemplates the debtor's authentication of a record. In the unlikely event that possession is obtained without the debtor's agreement, possession would not suffice as a substitute for an authenticated security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party's possession is maintained without the agreement of a subsequent debtor (e.g., a transferee). Possession as contemplated by section 9-313 is possession for purposes of subsection (b)(3)(B), even though it may not constitute possession "pursuant to the debtor's agreement" and consequently might not serve as a substitute for an authenticated security agreement under subsection (b)(3)(A). Subsection (b)(3)(C) provides that delivery of a certificated security to the secured party under section 8-301 pursuant to the debtor's security agreement is sufficient as a substitute for an authenticated security agreement. Similarly, under subsection (b)(3)(D), control of investment property, a deposit account, electronic chattel paper, or a letter-of-credit right satisfies the evidentiary test if control is pursuant to the debtor's security agreement.

5. **Collateral Covered by Other Statute or Treaty.** One evidentiary purpose of the formal requisites stated in subsection (b) is to minimize the possibility of future disputes as to the terms of a security agreement (e.g., as to the property that stands as collateral for the obligation secured). One should distinguish the evidentiary functions of the formal requisites of attachment and enforceability (such as the requirement that a security agreement contain a description of the collateral) from the more limited goals of "notice filing" for financing statements under part 5, explained in section 9-502, comment 2. When perfection is achieved by compliance with the requirements of a statute or treaty described in section 9-311(a), such as a federal recording act or a certificate-of-title statute, the manner of describing the collateral in a registry imposed by the statute or treaty may or may not be adequate for purposes of this section and section 9-108. However, the description contained in the security agreement, not the description in a public registry or on a certificate of title, controls for purposes of this section.

6. **Debtor's Rights; Debtor's Power to Transfer Rights.** Subsection (b)(2) conditions attachment on the debtor's having "rights in the collateral or the power to transfer rights in the collateral to a secured party." A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.

Certain exceptions to the baseline rule enable a debtor to transfer, and a security interest to attach to, greater rights than the debtor has. See part 3, subpart 3 (priority rules). The phrase, "or the power to transfer rights in the collateral to a secured party," accommodates those exceptions. In some cases, a debtor may have power to transfer another person's rights only to a class of transferees that excludes secured parties. See, e.g., section 2-403(2) (giving certain merchants power to transfer an entruster's rights to a buyer in ordinary course of business). Under those circumstances, the debtor would not have the power to create a security interest in the other person's rights, and the condition in subsection (b)(2) would not be satisfied.

7. **New Debtors.** Subsection (e) makes clear that the enforceability requirements of subsec-

tion (b)(3) are met when a new debtor becomes bound under an original debtor's security agreement. If a new debtor becomes bound as debtor by a security agreement entered into by another person, the security agreement satisfies the requirement of subsection (b)(3) as to the existing and after-acquired property of the new debtor to the extent the property is described in the agreement.

Subsection (d) explains when a new debtor becomes bound. Persons who become bound under paragraph (2) are limited to those who both become primarily liable for the original debtor's obligations and succeed to (or acquire) its assets. Thus, the paragraph excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other nonsuccessorship doctrines. In many cases, paragraph (2) will exclude successors to the assets and liabilities of a division of a debtor. See also section 9-508, comment 3.

8. **Supporting Obligations.** Under subsection (f), a security interest in a "supporting obligation" (defined in section 9-102) automatically follows from a security interest in the underlying, supported collateral. This result was implicit under former article 9. Implicit in subsection (f) is the principle that the secured party's interest in a supporting obligation extends to the supporting obligation only to the extent that it supports the collateral in which the secured party has a security interest. Complex issues may arise, however, if a supporting obligation supports many separate obligations of a particular account debtor and if the supported obligations are separately assigned as security to several secured parties. The problems may be exacerbated if a supporting obligation is limited to an aggregate amount that is less than the aggregate amount of the obligations it supports. This article does not contain provisions dealing with competing claims to a limited supporting obligation. As under former article 9, the law of suretyship and the agreements of the parties will control.

9. **Collateral Follows Right to Payment or Performance.** Subsection (g) codifies the common law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien. See Restatement (3d), Property (Mortgages) section 5.4(a) (1997). See also section 9-308(e) (analogous rule for perfection).

10. **Investment Property.** Subsections (h) and (i) make clear that attachment of a security interest in a securities account or commodity account is also attachment in security entitlements or commodity contracts carried in the accounts.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 45, effective October 1, 2006, in subdivision (b)(3)d., deleted "or" preceding "letter-of-credit," inserted "or electronic documents," and "25-7-106."

Legal Periodicals. — For article on statute of frauds as to personal property under the Uniform Commercial Code, see 4 Wake Forest Intra. L. Rev. 41 (1968).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

This section clearly requires that a security agreement be written, absent possession of the collateral by the secured party. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

Writing Requirement Is in Nature of

Statute of Frauds. — The requirement that the bargain be reduced to writing before it becomes effective is in the nature of a statute of frauds. Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976).

The formal requirement of a written security agreement is in the nature of a statute of frauds, and when bankruptcy occurs the anti-fraud function of the written security agreement serves mostly to protect third-party creditors. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

This statute does not make an Article 9 transaction subject to § 24-1.1. Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Writings May Be Incorporated to Satisfy Requirement. — As in other contracts involving a statute of frauds, two or more writings can be incorporated to satisfy the requirements of subsection (1)(a). Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976).

And Writing Need Not Be Denominated Security Agreement. — So long as there is written language which makes and evinces the bargain, it does not matter that the writing is not denominated a security agreement. Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976).

A security agreement need not be denominated as such and need not be a separately executed document to be enforceable. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

Instrument Must Manifest Intention to Create Security Interest. — There must be language in the instrument which leads to the logical conclusion that it was the intention of the parties that a security interest be created. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

The intent to create a security agreement must appear on the face of a written document or documents executed by the debtor. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

Though explicit language granting a security agreement is not necessary, there must appear within the transaction documents language showing an intent to create a security interest before a security agreement may be found. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

In an action regarding the purchase and sale of a business, in which the sellers counterclaimed on a promissory note executed by the buyer, the evidence showed that the security agreement was signed and proper, value was given through the transaction, and the buyer took possession of the collateral, so a valid security interest was created and had attached to the collateral, under G.S. 25-9-203(1), and the property was sufficiently described, as it only needed to be reasonably identified by the agreement, under G.S. 25-9-108. Kindred of N.C., Inc. v. Bond, 160 N.C. App. 90, 584 S.E.2d 846, 2003 N.C. App. LEXIS 1765 (2003).

Bankruptcy court found that there was a material factual dispute as to the debtor's intent to grant a security interest in the subject equipment as required by former G.S. 25-9-203(1), so the court denied the motion for partial summary judgment. Bank of Am. v. Outboard Marine Corp. (In re Outboard Marine Corp.), 300 B.R. 308, 2003 Bankr. LEXIS 1356 (Bankr. N.D. Ill. 2003).

Determination of whether a security interest exists is a two-step process. First, the court must determine as a question of law whether the language in the writing required by this section objectively indicates that the parties intended to create a security interest; second, if the statute of frauds requirement is met, then the factfinder must determine whether the parties actually intended to create a security interest. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

The Code distinguishes between a security agreement and a financing statement. The security agreement is a writing which (1) creates or provides for a security interest; (2) contains a description of the collateral, plus a description of the land involved when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut; and (3) is signed by the debtor. The financing statement is a writing which (1) contains the signature and addresses of both the debtor and creditor and (2) a description of the collateral plus a description of the land involved when the financing statement covers crops growing or to be grown or goods which are or are to become fixtures. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Although the Code contemplates the execution of two separate writings, it does not prohibit the combination of a security agreement and financing statement. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

A financing statement does not ordinarily create a security interest; it merely gives notice that one is or may be claimed. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971); E-B Grain Co. v. Denton, 73 N.C. App. 14, 325 S.E.2d 522, cert. denied, 313 N.C. 598, 330 S.E.2d 608 (1985).

A financing statement which did no more than meet the requirements of former G.S. 25-9-402 would not create a security interest in the debtor's property. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

The mere filing of a financing statement does not necessarily indicate that a security interest exists. E-B Grain Co. v. Denton, 73 N.C. App.

14, 325 S.E.2d 522, cert. denied, 313 N.C. 598, 330 S.E.2d 608 (1985).

Since a financing statement may be filed for reasons other than the perfection of an existing security interest, the filing of a financing statement alone is not enough to create a security interest; it is but one step by which the rights and priorities of a secured party are perfected. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

But a financing statement may double as a security agreement if it contains appropriate language which grants a security interest. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

A financing statement standing alone can serve as a sufficient memorandum of the security agreement. Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976).

If the financing statement contains the elements for a security agreement in addition to those for the financing statement, it would serve as the security agreement. The additional elements would be (1) something to indicate agreement; (2) a statement of the obligation or obligations secured; and, (3) provision for or creation of the security interest. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Where the financing statement contains language clearly manifesting the debtor's intent to grant, create, and provide for a security interest, bears his signature, describes the obligation secured, the collateral subject to the security interest, and the land involved, the financing statement meets the requirements of an enforceable security agreement and serves the double purpose. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Although the financing statement needed only to be a skeletonic statement that the parties intended to engage in future transactions which might never be consummated, former G.S. 25-9-402(1) specifically provided that "a copy of the security agreement was sufficient as a financing statement" if it contained the required information and was signed by both parties. There was no sound reason why a financing statement could not also serve as a security agreement if it met statutory requirements. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

A financing statement could serve as a written security agreement to satisfy subsection (1)(b). Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

A financing statement serves as notice to third parties that a security interest may be held in the property. Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 481 S.E.2d 670 (1997).

Purchase contract, read together with financing statement, did not constitute a security agreement, as the financing statement did no more than meet the requirements of former G.S. 25-9-402. Crocker v. Delta Group, Inc., 125 N.C. App. 583, 481 S.E.2d 694 (1997).

Security Agreement Established Limits of Security Interest. — Where security agreement was unambiguous and did not include after-acquired collateral, the security agreement, not the financing statement, established the scope or limits of the security interest. Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 481 S.E.2d 670 (1997).

The language of a promissory note, considered together with the terms and language of a financing statement, may be sufficient to create a security interest in collateral owned by the debtor on the note. Mitchell v. Rock Hill Nat'l Bank (In re Mid-Atlantic Piping Prods., Inc.), 24 Bankr. 314 (Bankr. W.D.N.C. 1982).

Use of Parole Evidence. — Parole evidence may be admitted to interpret an ambiguous writing, but may not be introduced to satisfy the statute of frauds requirement of this section. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

Treatment of Bill of Sale as Chattel Mortgage. — North Carolina accepts the majority common law rule that under certain circumstances a bill of sale, although absolute on its face, may be regarded as a chattel mortgage. In particular, an absolute bill of sale with an accompanying parol agreement that the purchaser will reconvey the property upon the repayment of the money within a certain time is a mortgage, and it will be treated as such. These common law rules have apparently survived the adoption of the Uniform Commercial Code. Beard v. Newsome, 76 N.C. App. 476, 333 S.E.2d 527 (1985).

Financing Statement Sufficient to Provide Security Interest. — Where the financing statement declared that it "covers the following type of collateral: (all crops now growing or to be planted on 5 specified farms) same securing note for advance money to produce crops for the year 1969," and the note contained the statement that it "is secured by Uniform Commercial Code financing statement of North Carolina," the financing statement and the note manifested defendant's intent to create in plaintiff a security interest in the described collateral and he did, in fact, provide for such interest when he stated that the crops described therein secured the note for money advanced to produce these crops. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Financing Statement Insufficient to Provide Security Interest. — Where collateral was owned by debtor corporation, and the name of that corporation appeared only on one of three documents, the financing statement, and the financing statement was not signed by any corporate officer of the debtor, no security interest was created because the document was not signed by the debtor in accordance with former G.S. 55-36(b). Little v. County of Orange, 31 N.C. App. 495, 229 S.E.2d 823 (1976).

"Rights in the collateral" was a term signifying not title, but merely some rights which could be transferred to the secured party. Nasco Equip. Co. v. Mason, 291 N.C. 145, 229 S.E.2d 278 (1976).

A debtor may acquire "rights in the collateral" even where the collateral consists of consigned goods. Nasco Equip. Co. v. Mason, 291 N.C. 145, 229 S.E.2d 278 (1976).

Right to Insurance Proceeds. — Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds, including insurance proceeds. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

The mere fact that plaintiff had a security interest was insufficient to give rise to a claim against defendant under Article 9 or otherwise. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Security Interest in Lessor Created Upon Lessee's Default. — A lease agreement between a lessor and lessee is held to create a security interest in favor of the lessor, upon the lessee's default under the lease, in property that was acquired by the lessee for use on the premises. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

No Particular Form of Agricultural Lien Was Required. — See Meekins v. Walker, 119 N.C. 46, 25 S.E. 706 (1896); Jones-Phillips Co. v. McCormick, 174 N.C. 82, 93 S.E. 449 (1917).

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Extending "Value." — Where a finance company refused to finance a vehicle because debtors failed to qualify, the finance company had no lien to assign to the creditor that ultimately extended financing and recorded its lien post-petition; the creditor's reliance on G.S. 25-1-201(44) was misplaced because there were numerous conditions that had to be satisfied before the finance company became bound to extend credit, none of which were ever satisfied. In re Josephs, — Bankr. —, 2005 Bankr. LEXIS 1421 (Bankr. M.D.N.C. July 15, 2005).

§ 25-9-204. After-acquired property; future advances.

(a) After-acquired collateral. — Except as otherwise provided in subsection (b) of this section, a security agreement may create or provide for a security interest in after-acquired collateral.

(b) When after-acquired property clause not effective. — A security interest does not attach under a term constituting an after-acquired property clause to:

(1) Consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; or

(2) A commercial tort claim.

(c) Future advances and other value. — A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with future advances or other value, whether or not the advances or value are given pursuant to commitment. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 2; c. 196, s. 1; 1955, c. 386, s. 1; c. 816; 1957, cc. 504, 999; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-204.

2. **After-Acquired Property; Continuing General Lien.** Subsection (a) makes clear that a security interest arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given. A security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party—such as a supple-

mental agreement covering the new collateral—is required. This section adopts the principle of a "continuing general lien" or "floating lien." It validates a security interest in the debtor's existing and (upon acquisition) future assets, even though the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. See section 9-205. Subsection (a), together with subsection (c), also validates "cross-collateral" clauses under which collateral acquired at any time secures advances whenever made.

3. **After-Acquired Consumer Goods.** Subsection (b)(1) makes ineffective an after-acquired property clause covering consumer goods (defined in section 9-109), except as accessions (see section 9-335), acquired more than 10 days after the secured party gives value. Subsection (b)(1) is unchanged in substance from the corresponding provision in former section 9-204(2).

4. **Commercial Tort Claims.** Subsection (b)(2) provides that an after-acquired property clause in a security agreement does not reach future commercial tort claims. In order for a security interest in a tort claim to attach, the claim must be in existence when the security agreement is authenticated. In addition, the security agreement must describe the tort claim with greater specificity than simply "all tort claims." See section 9-108(e).

5. **Future Advances; Obligations Secured.** Under subsection (c) collateral may secure future as well as past or present advances if the security agreement so provides. This is in line with the policy of this article toward security interests in after-acquired property under subsection (a). Indeed, the parties are free to agree that a security interest secures any obligation whatsoever. Determining the obligations secured by collateral is solely a matter of construing the parties' agreement under applicable law. This article rejects the holdings of cases decided under former article 9 that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral.

6. **Sales of Receivables.** Subsections (a) and (c) expressly validate after-acquired property and future advance clauses not only when the transaction is for security purposes but also when the transaction is the sale of accounts, chattel paper, payment intangibles, or promissory notes. This result was implicit under former article 9.

7. **Financing Statements.** The effect of after-acquired property and future advance clauses as components of a security agreement should not be confused with the requirements applicable to financing statements under this article's system of perfection by notice filing. The references to after-acquired property clauses and future advance clauses in this section are limited to security agreements. There is no need to refer to after-acquired property or future advances or other obligations secured in a financing statement. See section 9-502, comment 2.

Legal Periodicals. — For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

The UCC limits a security interest in after-acquired consumer goods to those acquired within 10 days after the lender gave value. Anderson v. Southern Disct. Co., 582 F.2d 883 (4th Cir. 1978).

Security Interest in "Additions and Accessions" to Listed Chattels. — Where a promissory note was secured by certain household goods, each of which was listed and identified, and the agreement also provided for a security interest in all additions and accessions to the listed chattels, the use of the words "additions and" did not constitute a violation of the Truth-in-Lending Act as broadly including all after-acquired furniture and household furnishings; the obvious meaning and the only proper interpretation of the phrase was that it covered only accessions, articles later acquired and physically attached to one of the listed articles. Anderson v. Southern Disct. Co., 582 F.2d 883 (4th Cir. 1978).

Security Interest in "After-Acquired Property". — The fact that a security agreement does not use the exact term "after-acquired property" does not mean that no security interest is granted with respect to after-acquired property. There are no magic words which must be used in order to obtain a security interest in after-required property. All that is required under G.S. 25-9-204 is that the security agreement contain language reflecting an intention to create a security interest in after-acquired collateral. Magers v. Bonds (In re Bonds Distrib. Co.), — Bankr. —, 2000 Bankr. LEXIS 1964 (Bankr. M.D.N.C. Mar. 31, 2000).

Execution of Agreement and Furnishing of Supplies Treated as Contemporaneous. — When furnishing supplies and making securing instruments were contemporaneous, constituting one transaction of which these acts were parts, it was not material which preceded which in actual time, for in contemplation of law both were done at one and the same time. This view was suggested in Womble v. Leach, 83 N.C. 84 (1880), as a reasonable construction which accomplished the substantial purposes intended. Reese & Co. v. Cole, 93 N.C. 87 (1885).

Crops Covered by Lien. — The operations of a mortgage or agricultural lien in respect to crops were confined to crops then or about to be planted, and did not extend further than those planted next after the execution of the instrument. Wooten v. Hill, 98 N.C. 48, 3 S.E. 846 (1887).

§ 25-9-205. Use or disposition of collateral permissible.

(a) When security interest not invalid or fraudulent. — A security interest is not invalid or fraudulent against creditors solely because:

(1) The debtor has the right or ability to:
  a. Use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;
  b. Collect, compromise, enforce, or otherwise deal with collateral;
  c. Accept the return of collateral or make repossessions; or
  d. Use, commingle, or dispose of proceeds; or

(2) The secured party fails to require the debtor to account for proceeds or replace collateral.

(b) Requirements of possession not relaxed. — This section does not relax the requirements of possession if attachment, perfection, or enforcement of a security interest depends upon possession of the collateral by the secured party. (1945, c. 196, s. 7; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

Editor's Note.

1. **Source.** Former section 9-205.

2. **Validity of Unrestricted "Floating Lien."** This article expressly validates the "floating lien" on shifting collateral. See sections 9-201, 9-204, and comment 2. This section provides that a security interest is not invalid or fraudulent by reason of the debtor's liberty to dispose of the collateral without being required to account to the secured party for proceeds or substitute new collateral. As did former section 9-205, this section repeals the rule of Benedict v. Ratner, 268 U.S. 353 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over collateral. The Benedict rule did not effectively discourage or eliminate security transactions in inventory and receivables. Instead, it forced financing arrangements to be self-liquidating. Although this section repeals Benedict, the filing and other perfection requirements (see part 3, subpart 2, and part 5) provide for public notice that overcomes any potential misleading effects of a debtor's use and control of collateral. Moreover, nothing in this section prevents the debtor and secured party from agreeing to procedures by which the secured party polices or monitors collateral or to restrictions on the debtor's dominion. However, this article leaves these matters to agreement based on business considerations, not on legal requirements.

3. **Possessory Security Interests.** Subsection (b) makes clear that this section does not relax the requirements for perfection by possession under section 9-313. If a secured party allows the debtor access to and control over collateral its security interest may be or become unperfected.

4. **Permissible Freedom for Debtor to Enforce Collateral.** Former section 9-205 referred to a debtor's "liberty ...to collect or compromise accounts or chattel paper." This section recognizes the broader rights of a debtor to "enforce," as well as to "collect" and "compromise" collateral. This section's reference to collecting, compromising, and enforcing "collateral" instead of "accounts or chattel paper" contemplates the many other types of collateral that a debtor may wish to "collect, compromise, or enforce": E.g., deposit accounts, documents, general intangibles, instruments, investment property, and letter-of-credit rights.

§ 25-9-206. Security interest arising in purchase or delivery of financial asset.

(a) Security interest when person buys through securities intermediary. — A security interest in favor of a securities intermediary attaches to a person's security entitlement if:

(1) The person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and

(2) The securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

(b) Security interest secures obligation to pay for financial asset. — The security interest described in subsection (a) of this section secures the person's obligation to pay for the financial asset.

(c) Security interest in payment against delivery transaction. — A security interest in favor of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if:

(1) The security or other financial asset:

a. In the ordinary course of business is transferred by delivery with any necessary indorsement or assignment; and

b. Is delivered under an agreement between persons in the business of dealing with such securities or financial assets; and

(2) The agreement calls for delivery against payment.

(d) Security interest secures obligation to pay for delivery. — The security interest described in subsection (c) of this section secures the obligation to make payment for the delivery. (1997-181, s. 6; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-116.

2. **Codification of "Broker's Lien."** Depending upon a securities intermediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to financial assets before the entitlement holder has actually made payment for them. For example, many brokers permit retail customers to pay for financial assets by check. The broker may not receive final payment of the check until several days after the broker has credited the customer's securities account for the financial assets. Thus, the customer will have acquired a security entitlement prior to payment. Subsection (a) provides that, in such circumstances, the securities intermediary has a security interest in the entitlement holder's security entitlement. Under subsection (b) the security interest secures the customer's obligation to pay for the financial asset in question. Subsections (a) and (b) codify and adapt to the indirect holding system the so-called "broker's lien," which has long been recognized. See Restatement, Security section 12.

3. **Financial Assets Delivered Against Payment.** Subsection (c) creates a security interest in favor of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In some arrangements for settlement of transactions in physical financial assets, the seller's securities custodian will deliver physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Subsection (c) clarifies the rights of persons making deliveries in such circumstances. It provides the person making delivery with a security interest in the securities or other financial assets; under subsection (d), the security interest secures the seller's right to receive payment for the delivery. Section 8-301 specifies when delivery of a certificated security occurs; that section should be applied as well to other financial assets as well

for purposes of this section.

4. **Automatic Attachment and Perfection.** Subsections (a) and (c) refer to attachment of a security interest. Attachment under this section has the same incidents (enforceability, right to proceeds, etc.) as attachment under section 9-203. This section overrides the general attachment rules in section 9-203. See section 9-203(c). A securities intermediary's security interest under subsection (a) is perfected by control without further action. See sections 8-106 (control) and 9-314 (perfection). Security interests arising under subsection (c) are automatically perfected. See section 9-309(9).

Subpart 2. Rights and Duties.

§ 25-9-207. Rights and duties of secured party having possession or control of collateral.

(a) Duty of care when secured party in possession. — Except as otherwise provided in subsection (d) of this section, a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) Expenses, risks, duties, and rights when secured party in possession. — Except as otherwise provided in subsection (d) of this section, if a secured party has possession of collateral:

(1) Reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) The risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(3) The secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(4) The secured party may use or operate the collateral:

a. For the purpose of preserving the collateral or its value;

b. As permitted by an order of a court having competent jurisdiction; or

c. Except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(c) Rights and duties when secured party in possession or control. — Except as otherwise provided in subsection (d) of this section, a secured party having possession of collateral or control of collateral under G.S. 25-7-106, 25-9-104, 25-9-105, 25-9-106, or 25-9-107:

(1) May hold as additional security any proceeds, except money or funds, received from the collateral;

(2) Shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor; and

(3) May create a security interest in the collateral.

(d) Buyer of certain rights to payment. — If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(1) Subsection (a) of this section does not apply unless the secured party is entitled under an agreement:

a. To charge back uncollected collateral; or

b. Otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral; and

(2) Subsections (b) and (c) of this section do not apply. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1; 2006-112, s. 46.)

OFFICIAL COMMENT

1. **Source.** Former section 9-207.

2. **Duty of Care for Collateral in Secured Party's Possession.** Like former section 9-207, subsection (a) imposes a duty of care, similar to that imposed on a pledgee at common law, on a secured party in possession of collateral. See Restatement, Security sections 17 and 18. In many cases a secured party in possession of collateral may satisfy this duty by notifying the debtor of action that should be taken and allowing the debtor to take the action itself. If the secured party itself takes action, its reasonable expenses may be added to the secured obligation. The revised definitions of "collateral," "debtor," and "secured party" in section 9-102 make this section applicable to collateral subject to an agricultural lien if the collateral is in the lienholder's possession. Under section 1-102 the duty to exercise reasonable care may not be disclaimed by agreement, although under that section the parties remain free to determine by agreement standards that are not manifestly unreasonable as to what constitutes reasonable care. Unless otherwise agreed, for a secured party in possession of chattel paper or an instrument, reasonable care includes the preservation of rights against prior parties. The secured party's right to have instruments or documents indorsed or transferred to it or its order is dealt with in the relevant sections of articles 3, 7, and 8. See sections 3-201, 7-506, and 8-304(d).

3. **Specific Rules When Secured Party in Possession or Control of Collateral.** Subsections (b) and (c) provide rules following common law precedents which apply unless the parties otherwise agree. The rules in subsection (b) apply to typical issues that may arise while a secured party is in possession of collateral, including expenses, insurance, and taxes, risk of loss or damage, identifiable and fungible collateral, and use or operation of collateral. Subsection (c) contains rules that apply in certain circumstances that may arise when a secured party is in either possession or control of collateral. These circumstances include the secured party's receiving proceeds from the collateral and the secured party's creation of a security interest in the collateral.

4. **Applicability Following Default.** This section applies when the secured party has possession of collateral either before or after default. See sections 9-601(b) and 9-609. Subsection (b)(4)(C) limits agreements concerning the use or operation of collateral to collateral other than consumer goods. Under section 9-602(1), a debtor cannot waive or vary that limitation.

5. **"Repledges" and Right of Redemption.** Subsection (c)(3) eliminates the qualification in former section 9-207 to the effect that the terms of a "repledge" may not "impair" a debtor's "right to redeem" collateral. The change is primarily for clarification. There is no basis on which to draw from subsection (c)(3) any inference concerning the debtor's right to redeem the collateral. The debtor enjoys that right under section 9-623; this section need not address it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor's unimpaired right to redeem as against the debtor's original secured party nevertheless may not be enforceable as against the new secured party.

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish D's rights against SP-1 from D's rights against SP-2. Once D discharges the secured obligation, D becomes entitled to the note; SP-1 has no legal basis upon which to withhold it. If, as a practical matter, SP-1 is unable to return the note because SP-2 holds it as collateral for SP-1's unpaid debt, then SP-1 is liable to D under the law of conversion.

Whether SP-2 would be liable to D depends on the relative priority of SP-2's security interest and D's interest. By permitting SP-1 to create a security interest in the collateral (repledge), subsection (c)(3) provides a statutory power for SP-1 to give SP-2 a security interest (subject, of course, to any agreement by SP-1 not to give a security interest). In the vast majority of cases where repledge rights are significant, the security interest of the second secured party, SP-2 in the example, will be senior to the debtor's interest. By virtue of the debtor's consent or applicable legal rules, SP-2 typically would cut off D's rights in investment property or be immune from D's claims. See sections 3-306 and 9-331 (holder in due course), 8-303 (protected purchaser), 8-502 (acquisition of a security entitlement), and 8-503(e) (action by entitlement holder). Moreover, the expectations and business practices in some markets, such as the securities markets, are such that D's consent to SP-2's taking free of D's rights inheres in D's creation of SP-1's security interest which gives rise to SP-1's power under this section. In these situations, D would have no right to recover the collateral or recover damages from SP-2. Nevertheless, D would have a damage claim against SP-1 if SP-1 had given a security interest to SP-2 in breach of its agreement with D. Moreover, if SP-2's security interest secures an amount that is less than the amount secured by SP-1's security interest (granted by D), then D's exercise of its right to redeem would provide value sufficient to discharge SP-1's obligations to SP-2.

For the most part this section does not change the law under former section 9-207, although eliminating the reference to the debtor's right of redemption may alter the secured party's right to repledge in one respect. Former section 9-207 could have been read to limit the secured party's statutory right to repledge collateral to repledge transactions in which the collateral did not secure a greater obligation than that of the original debtor. Inasmuch as this is a matter normally dealt with by agreement between the debtor and secured party, any change would appear to have little practical effect.

6. **"Repledges" of Investment Property.** The following example will aid the discussion of "repledges" of investment property.

Example. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Beta then credits Alpha's account. Alpha has control of the security entitlement for the 1000 shares under section 8-106(d). (These are the facts of Example 2, section 8-106, comment 4.) Although, as between Debtor and Alpha, Debtor may have become the beneficial owner of the new securities entitlement with Beta, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Next, Alpha grants Gamma Bank a security interest in the security entitlement with Beta that includes the 1000 shares of XYZ Co. stock. In order to afford Gamma control of the entitlement, Alpha instructs Beta to transfer the stock to Gamma's custodian, Delta Bank, which credits Gamma's account for 1000 shares. At this point Gamma holds its securities entitlement for its benefit as well as that of its debtor, Alpha. Alpha's derivative rights also are for the benefit of Debtor.

In many, probably most, situations and at any particular point in time, it will be impossible for Debtor or Alpha to "trace" Alpha's "repledge" to any particular securities entitlement or financial asset of Gamma or anyone else. Debtor would retain, of course, a right to redeem the collateral from Alpha upon satisfaction of the secured obligation. However, in the absence of a traceable interest, Debtor would retain only a personal claim against Alpha in the event Alpha failed to restore the security entitlement to Debtor. Moreover, even in the unlikely event that Debtor could trace a property interest, in the context of the financial markets, normally the operation of this section, Debtor's explicit agreement to permit Alpha to create a senior security interest, or legal rules permitting Gamma to cut off Debtor's rights or become immune from Debtor's claims would effectively subordinate Debtor's interest to the holder of a security interest created by Alpha. And, under the shelter principle, all subsequent transferees would obtain interests to which Debtor's interest also would be subordinate.

7. **Buyers of Chattel Paper and Other Receivables; Consignors.** This section has been revised to reflect the fact that a seller of accounts, chattel paper, payment intangibles, or promissory notes retains no interest in the collateral and so is not disadvantaged by the secured party's noncompliance with the requirements of this section. Accordingly, subsection (d) provides that subsection (a) applies only to security interests that secure an obligation and to sales of receivables in which the buyer has recourse against the debtor. (Of course, a buyer of accounts or payment intangibles could not have "possession" of original collateral, but might have possession of proceeds, such as promissory notes or checks.) The meaning of "recourse" in this respect is limited to recourse arising out of the account debtor's failure to pay or other default.

Subsection (d) makes subsections (b) and (c) inapplicable to buyers of accounts, chattel paper, payment intangibles, or promissory notes and consignors. Of course, there is no reason to believe that a buyer of receivables or a consignor could not, for example, create a security interest or otherwise transfer an interest in the collateral, regardless of who has possession of the collateral. However, this section leaves the rights of those owners to law other than article 9.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of

Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 46, effective October 1, 2006, inserted "25-7-106" in the introductory language of subsection (c).

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Obligation Not Applicable Until Right of Possession Is Exercised. — The obligations of the secured party to secure and protect the collateral are not applicable unless and until the party has exercised his right of possession. North Carolina Nat'l Bank v. Sharpe, 35 N.C. 404, 241 S.E.2d 360 (1978).

Ownership of Repossessed Collateral in Bankruptcy. — Until a creditor disposes of the repossessed property, the debtor remains the legal and equitable owner, subject only to the creditor's debt collection remedies, which are suspended by 11 U.S.C.S. § 362(a) when a bankruptcy petition is filed; where a Chapter 13 debtor's vehicle was repossessed prior to debtor filing his bankruptcy petition, debtor retained ownership of the repossessed vehicle and the vehicle automatically became part of the bankruptcy estate when debtor filed his petition. In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-208. Additional duties of secured party having control of collateral.

(a) Applicability of section. — This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) Duties of secured party after receiving demand from debtor. — Within 10 days after receiving an authenticated demand by the debtor:

(1) A secured party having control of a deposit account under 25-9-104(a)(2) shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;

(2) A secured party having control of a deposit account under G.S. 25-9-104(a)(3) shall:
  a. Pay the debtor the balance on deposit in the deposit account; or
  b. Transfer the balance on deposit into a deposit account in the debtor's name;

(3) A secured party, other than a buyer, having control of electronic chattel paper under G.S. 25-9-105 shall:
  a. Communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;
  b. If the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
  c. Take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party;

(4) A secured party having control of investment property under G.S. 25-8-106(d)(2) or G.S. 25-9-106(b) shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party;

(5) A secured party having control of a letter-of-credit right under G.S. 25-9-107 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party; and

(6) A secured party having control of an electronic document shall:
   a. Give control of the electronic document to the debtor or its designated custodian;
   b. If the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic document is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
   c. Take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party. (2000-169, s. 1; 2006-112, s. 47.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope and Purpose.** This section imposes duties on a secured party who has control of a deposit account, electronic chattel paper, investment property, or a letter-of-credit right. The duty to terminate the secured party's control is analogous to the duty to file a termination statement, imposed by section 9-513. Under subsection (a), it applies only when there is no outstanding secured obligation and the secured party is not committed to give value. The requirements of this section can be varied by agreement under section 1-102(3). For example, a debtor could by contract agree that the secured party may comply with subsection (b) by releasing control more than 10 days after demand. Also, duties under this section should not be read to conflict with the terms of the collateral itself. For example, if the collateral is a time deposit account, subsection (b)(2) should not require a secured party with control to make an early withdrawal of the funds (assuming that were possible) in order to pay them over to the debtor or put them in an account in the debtor's name.

3. **Remedy for Failure to Relinquish Control.** If a secured party fails to comply with the requirements of subsection (b), the debtor has the remedy set forth in section 9-625(e). This remedy is identical to that applicable to failure to provide or file a termination statement under section 9-513.

4. **Duty to Relinquish Possession.** Although section 9-207 addresses directly the duties of a secured party in possession of collateral, that section does not require the secured party to relinquish possession when the secured party ceases to hold a security interest. Under common law, absent agreement to the contrary, the failure to relinquish possession of collateral upon satisfaction of the secured obligation would constitute a conversion. Inasmuch as problems apparently have not surfaced in the absence of statutory duties under former article 9 and the common law duty appears to have been sufficient, this article does not impose a statutory duty to relinquish possession.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 47, effective October 1, 2006, added subdivision (b)(6); and made minor stylistic changes.

§ 25-9-209. Duties of secured party if account debtor has been notified of assignment.

(a) Applicability of section. — Except as otherwise provided in subsection (c) of this section, this section applies if:

(1) There is no outstanding secured obligation; and

(2) The secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) Duties of secured party after receiving demand from debtor. — Within 10 days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under G.S. 25-9-406(a) an authenticated record that releases the account debtor from any further obligation to the secured party.

(c) Inapplicability to sales. — This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope and Purpose.** Like sections 9-208 and 9-513, which require a secured party to relinquish control of collateral and to file or provide a termination statement for a financing statement, this section requires a secured party to free up collateral when there no longer is any outstanding secured obligation or any commitment to give value in the future. This section addresses the case in which account debtors have been notified to pay a secured party to whom the receivables have been assigned. It requires the secured party (assignee) to inform the account debtors that they no longer are obligated to make payment to the secured party. See subsection (b). It does not apply to account debtors whose obligations on an account, chattel paper, or payment intangible have been sold. See subsection (c).

§ 25-9-210. Request for accounting; request regarding list of collateral or statement of account.

(a) Definitions. — In this section:

(1) "Request" means a record of a type described in subdivision (2), (3), or (4) of this subsection.

(2) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request.

(3) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation

and reasonably identifying the transaction or relationship that is the subject of the request.

(4) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(b) Duty to respond to requests. — Subject to subsections (c), (d), (e), and (f) of this section, a secured party, other than a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor, shall comply with a request within 14 days after receipt:

(1) In the case of a request for an accounting, by authenticating and sending to the debtor an accounting; and

(2) In the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(c) Request regarding list of collateral; statement concerning type of collateral. — A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within 14 days after receipt.

(d) Request regarding list of collateral; no interest claimed. — A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and claimed an interest in the collateral at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) Disclaiming any interest in the collateral; and

(2) If known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the collateral.

(e) Request for accounting or regarding statement of account; no interest in obligation claimed. — A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request, and claimed an interest in the obligations at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) Disclaiming any interest in the obligations; and

(2) If known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) Charges for responses. — A debtor is entitled without charge to one response to a request under this section during any six-month period. The secured party may require payment of a charge not exceeding twenty-five dollars ($25.00) for each additional response. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-208.

2. **Scope and Purpose.** This section provides a procedure whereby a debtor may obtain from a secured party information about the secured obligation and the collateral in which the secured party may claim a security interest. It clarifies and resolves some of the issues that arose under former section 9-208 and makes information concerning the secured indebtedness readily available to debtors, both before and after default. It applies to agricultural lien transactions (see the definitions of "debtor," "secured party," and "collateral" in section 9-102), but generally not to sales of receivables. See subsection (b).

3. **Requests by Debtors Only.** A financing statement filed under part 5 may disclose only that a secured party may have a security interest in specified types of collateral. In most cases the financing statement will contain no indica-

tion of the obligation (if any) secured, whether any security interest actually exists, or the particular property subject to a security interest. Because creditors of and prospective purchasers from a debtor may have legitimate needs for more detailed information, it is necessary to provide a procedure under which the secured party will be required to provide information. On the other hand, the secured party should not be under a duty to disclose any details of the debtor's financial affairs to any casual inquirer or competitor who may inquire. For this reason, this section gives the right to request information to the debtor only. The debtor may submit a request in connection with negotiations with subsequent creditors and purchasers, as well as for the purpose of determining the status of its credit relationship or demonstrating which of its assets are free of a security interest.

4. **Permitted Types of Requests for Information.** Subsection (a) contemplates that a debtor may request three types of information by submitting three types of "requests" to the secured party. First, the debtor may request the secured party to prepare and send an "accounting" (defined in section 9-102). Second, the debtor may submit to the secured party a list of collateral for the secured party's approval or correction. Third, the debtor may submit to the secured party for its approval or correction a statement of the aggregate amount of unpaid secured obligations. Inasmuch as a secured party may have numerous transactions and relationships with a debtor, each request must identify the relevant transactions or relationships. Subsections (b) and (c) require the secured party to respond to a request within 14 days following receipt of the request.

5. **Recipients Claiming No Interest in the Transaction.** A debtor may be unaware that a creditor with whom it has dealt has assigned its security interest or the secured obligation. Subsections (d) and (e) impose upon recipients of requests under this section the duty to inform the debtor that they claim no interest in the collateral or secured obligation, respectively, and to inform the debtor of the name and mailing address of any known assignee or successor. As under subsections (b) and (c), a response to a request under subsection (d) or (e) is due 14 days following receipt.

6. **Waiver; Remedy for Failure to Comply.** The debtor's rights under this section may not be waived or varied. See section 9-602(2). Section 9-625 sets forth the remedies for noncompliance with the requirements of this section.

7. **Limitation on Free Responses to Requests.** Under subsection (f), during a six-month period a debtor is entitled to receive from the secured party one free response to a request. The debtor is not entitled to a free response to each type of request (i.e., three free responses) during a six-month period.

PART 3.

PERFECTION AND PRIORITY.

Subpart 1. Law Governing Perfection and Priority.

§ 25-9-301. Law governing perfection and priority of security interests.

Except as otherwise provided in G.S. 25-9-303 through G.S. 25-9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4) of this section, while tangible negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

a. Perfection of a security interest in the goods by filing a fixture filing;
b. Perfection of a security interest in timber to be cut; and
c. The effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1; 2006-112, s. 48.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former sections 9-103(1)(a) and (b), 9-103(3)(a) and (b), and 9-103(5), substantially modified.

2. **Scope of this Subpart.** Part 3, subpart 1 (sections 9-301 through 9-307) contains choice of law rules similar to those of former section 9-103. Former section 9-103 generally addresses which state's law governs "perfection and the effect of perfection or nonperfection of" security interests. See, e.g., former section 9-103(1)(b). This article follows the broader and more precise formulation in former section 9-103(6)(b), which was revised in connection with the promulgation of revised article 8 in 1994: "Perfection, the effect of perfection or nonperfection, and the priority of" security interests. Priority, in this context, subsumes all of the rules in part 3, including "cut off" or "take free" rules such as sections 9-317(b), (c), and (d), 9-320(a), (b), and (d), and 9-332. This subpart does not address choice of law for other purposes. For example, the law applicable to issues such as attachment, validity, characterization (e.g., true lease or security interest), and enforcement is governed by the rules in section 1-105; that governing law typically is specified in the same agreement that contains the security agreement. And, another jurisdiction's law may govern other third-party matters addressed in this article. See section 9-401, comment 3.

3. **Scope of Referral.** In designating the jurisdiction whose law governs, this article directs the court to apply only the substantive ("local") law of a particular jurisdiction and not its choice of law rules.

Example 1: Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the official text of this article, which provides that priority is determined by the local law of the jurisdiction in which the debtor is located. See section 9-301(1). The debtor is located in State Y. Even if State Y has retained former article 9 or enacted a nonuniform choice of law rule (e.g., one that provides that perfection is governed by the law of State Z), a State X court should look only to the substantive law of State Y and disregard State Y's choice of law rule. State Y's substantive law (e.g., its section 9-501) provides that financing statements should be filed in a filing office in State Y. Note, however, that if the identical perfection issue were to be litigated in State Y, the court would look to State Y's former section 9-103 or nonuniform section 9-301 and conclude that a filing in State Y is ineffective.

Example 2: In the preceding example, assume that State X has adopted the official text of this article, and State Y has adopted a nonuniform section 9-301(1) under which perfection is governed by the whole law of State X, including its choice of law rules. If litigation occurs in State X, the court should look to the substantive law of State Y, which provides that financing statements are to be filed in a filing office in State Y. If litigation occurs in State Y, the court should look to the law of State X, whose choice of law rule requires that the court apply the substantive law of State Y. Thus, regardless of the jurisdiction in which the litigation arises, the financing statement should be filed in State Y.

4. **Law Governing Perfection: General Rule.** Paragraph (1) contains the general rule: The law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under section 9-307.

Paragraph (1) substantially simplifies the choice of law rules. Former section 9-103 contained different choice of law rules for different types of collateral. Under section 9-301(1), the law of a single jurisdiction governs perfection with respect to most types of collateral, both tangible and intangible. Paragraph (1) eliminates the need for former section 9-103(1)(c), which concerned purchase-money security interests in tangible collateral that is intended to move from one jurisdiction to the other. It is likely to reduce the frequency of cases in which the governing law changes after a financing statement is properly filed. (Presumably, debtors change their own location less frequently than they change the location of their collateral.) The approach taken in paragraph (1) also eliminates some difficult priority issues and the need to distinguish between "mobile" and "ordinary" goods, and it reduces the number of filing offices in which secured parties must file or search when collateral is located in several jurisdictions.

5. **Law Governing Perfection: Exceptions.** The general rule is subject to several exceptions. It does not apply to goods covered by a certificate of title (see section 9-303), deposit accounts (see section 9-304), investment property (see section 9-305), or letter-of-credit rights (see section 9-306). Nor does it apply to possessory security interests, i.e., security interests that the secured party has perfected by taking possession of the collateral (see paragraph (2)), security interests perfected by filing a fixture filing (see subparagraph (3)(A)), security interests in timber to be cut (subparagraph (3)(B)), or security interests in as-extracted collateral (see paragraph (4)).

a. **Possessory Security Interests.** Paragraph (2) applies to possessory security interests and provides that perfection is governed by the local law of the jurisdiction in which the collateral is located. This is the rule of former section 9-103(1)(b), except paragraph (2) eliminates the troublesome "last event" test of former law.

The distinction between nonpossessory and possessory security interests creates the potential for the same jurisdiction to apply two different choice of law rules to determine perfection in the same collateral. For example, were a secured party in possession of an instrument or document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor. The applicability of two different choice of law rules for perfection is unlikely to lead to any material practical problems. The perfection rules of one article 9 jurisdiction are likely to be identical to those of another. Moreover, under paragraph (3), the relative priority of competing security interests in tangible collateral is resolved by reference to the law of the jurisdiction in which the collateral is located, regardless of how the security interests are perfected.

b. **Fixtures.** Application of the general rule in paragraph (1) to perfection of a security interest in fixtures would yield strange results. For example, perfection of a security interest in fixtures located in Arizona and owned by a Delaware corporation would be governed by the law of Delaware. Although Delaware law would send one to a filing office in Arizona for the place to file a financing statement as a fixture filing, see section 9-501, Delaware law would not take account of local, nonuniform, real property filing and recording requirements that Arizona law might impose. For this reason, paragraph (3)(A) contains a special rule for security interests perfected by a fixture filing; the law of the jurisdiction in which the fixtures are located governs perfection, including the formal requisites of a fixture filing. Under paragraph (3)(C), the same law governs priority. Fixtures are "goods" as defined in section 9-102.

c. **Timber to Be Cut.** Application of the general rule in paragraph (1) to perfection of a security interest in timber to be cut would yield undesirable results analogous to those described with respect to fixtures. Paragraph (3)(B) adopts a similar solution: Perfection is governed by the law of the jurisdiction in which the timber is located. As with fixtures, under paragraph (3)(C), the same law governs priority. Timber to be cut also is "goods" as defined in section 9-102.

Paragraph (3)(B) applies only to "timber to be cut," not to timber that has been cut. Consequently, once the timber is cut, the general choice of law rule in paragraph (1) becomes applicable. To ensure continued perfection, a secured party should file in both the jurisdiction in which the timber to be cut is located and in the state where the debtor is located. The former filing would be with the office in which a real property mortgage would be filed, and the latter would be a central filing. See section 9-501.

d. **As-Extracted Collateral.** Paragraph (4) adopts the rule of former section 9-103(5) with respect to certain security interests in minerals and related accounts. Like security interests in fixtures perfected by filing a fixture filing, security interests in minerals that are as-extracted collateral are perfected by filing in the office designated for the filing or recording of a mortgage on the real property. For the same reasons, the law governing perfection and priority is the law of the jurisdiction in which the wellhead or minehead is located.

6. **Change in Law Governing Perfection.** When the debtor changes its location to another jurisdiction, the jurisdiction whose law governs perfection under paragraph (1) changes, as well. Similarly, the law governing perfection of a possessory security interest in collateral under paragraph (2) changes when the collateral is removed to another jurisdiction. Nevertheless, these changes will not result in an immediate loss of perfection. See section 9-316(a) and (b).

7. **Law Governing Effect of Perfection and Priority: Goods, Documents, Instruments, Money, Negotiable Documents, and Tangible Chattel Paper.** Under former section 9-103, the law of a single jurisdiction governed both questions of perfection and those of priority. This article generally adopts that approach. See paragraph (1). But the approach

may create problems if the debtor and collateral are located in different jurisdictions. For example, assume a security interest in equipment located in Pennsylvania is perfected by filing in Illinois, where the debtor is located. If the law of the jurisdiction in which the debtor is located were to govern priority, then the priority of an execution lien on goods located in Pennsylvania would be governed by rules enacted by the Illinois legislature.

To address this problem, paragraph (3)(C) divorces questions of perfection from questions of "the effect of perfection or nonperfection and the priority of a security interest." Under paragraph (3)(C), the rights of competing claimants to tangible collateral are resolved by reference to the law of the jurisdiction in which the collateral is located. A similar bifurcation applied to security interests in investment property under former section 9-103(6). See section 9-305.

Paragraph (3)(C) applies the law of the situs to determine priority only with respect to goods (including fixtures), instruments, money, negotiable documents, and tangible chattel paper. Compare former section 9-103(1), which applied the law of the location of the collateral to documents, instruments, and "ordinary" (as opposed to "mobile") goods. This article does not distinguish among types of goods. The ordinary/mobile goods distinction appears to address concerns about where to file and search, rather than concerns about priority. There is no reason to preserve this distinction under the bifurcated approach.

Particularly serious confusion may arise when the choice of law rules of a given jurisdiction result in each of two competing security interests in the same collateral being governed by a different priority rule. The potential for this confusion existed under former section 9-103(4) with respect to chattel paper: Perfection by possession was governed by the law of the location of the paper, whereas perfection by filing was governed by the law of the location of the debtor. Consider the mess that would have been created if the language or interpretation of former section 9-308 were to differ in the two relevant states, or if one of the relevant jurisdictions (e.g., a foreign country) had not adopted article 9. The potential for confusion could have been exacerbated when a secured party perfected both by taking possession in the state where the collateral is located (State A) and by filing in the state where the debtor is located (State B)—a common practice for some chattel paper financers. By providing that the law of the jurisdiction in which the collateral is located governs priority, paragraph (3) substantially diminishes this problem.

8. **Non-U.S. Debtors.** This article applies the same choice of law rules to all debtors, foreign and domestic. For example, it adopts the bifurcated approach for determining the law applicable to security interests in goods and other tangible collateral. See comment 5(a), above. The article contains a new rule specifying the location of non-U.S. debtors for purposes of this part. The rule appears in section 9-307 and is explained in the Comments to that section. Former section 9-103(3)(c), which contained a special choice of law rule governing security interests created by debtors located in a non-U.S. jurisdiction, proved unsatisfactory and was deleted.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 48, effective October 1, 2006, inserted "tangible" preceding "negotiable documents" in the introductory language of subdivision (3).

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Certainty, Efficiency, and Realism: Rights in Collateral Under Article 9 of the Uniform Commercial Code," see 73 N.C.L. Rev. 115 (1994).

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

It is the exclusion of third parties which is the essence of perfection of a security interest. Westchase I Assocs. v. Lincoln Nat'l Life Ins. Co., 126 Bankr. 692 (W.D.N.C. 1991).

Security Interests in Motor Vehicles. — With reference to vehicles subject to registration with the Division of Motor Vehicles, the provisions of G.S. 20-58 et seq. are the exclusive statutory authority governing the perfecting of security interests in motor vehicles. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

Applied in In re Augusta Tissue Mill, LLC, — Bankr. —, 2007 Bankr. LEXIS 3040 (Bankr. M.D.N.C. Sept. 5, 2007).

Cited in Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-302. Law governing perfection and priority of agricultural liens.

While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Agricultural Liens.** This section provides choice of law rules for agricultural liens on farm products. Perfection, the effect of perfection or nonperfection, and priority all are governed by the law of the jurisdiction in which the farm products are located. Other choice of law rules, including section 1-105, determine which jurisdiction's law governs other matters, such as the secured party's rights on default. See section 9-301, comment 2. Inasmuch as no agricultural lien on proceeds arises under this article, this section does not expressly apply to proceeds of agricultural liens. However, if another statute creates an agricultural lien on proceeds, it may be appropriate for courts to apply the choice of law rule in this section to determine priority in the proceeds.

CASE NOTES

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-303. Law governing perfection and priority of security interests in goods covered by a certificate of title.

(a) Applicability of section. — This section applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

(b) When goods covered by certificate of title. — Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

(c) Applicable law. — The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-103(2)(a) and (b), substantially revised.

2. **Scope of This Section.** This section applies to "goods covered by a certificate of title." The new definition of "certificate of title" in section 9-102 makes clear that this section applies not only to certificate-of-title statutes under which perfection occurs upon notation of the security interest on the certificate but also to those that contemplate notation but provide that perfection is achieved by another method, e.g., delivery of designated documents to an official. Subsection (a), which is new, makes clear that this section applies to certificates of a jurisdiction having no other contacts with the goods or the debtor. This result comports with most of the reported cases on the subject and with contemporary business practices in the trucking industry.

3. **Law Governing Perfection and Priority.** Subsection (c) is the basic choice of law rule for goods covered by a certificate of title. Perfection and priority of a security interest are governed by the law of the jurisdiction under whose certificate of title the goods are covered from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction's certificate-of-title statute and a resulting notation of the security interest on the certificate of title. See section 9-311(b). In the typical case of an automobile or over-the-road truck, a person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But certificates of title cover certain types of goods in some states but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction in which the debtor is located. If the goods had been titled in another jurisdiction, the lender would be unperfected.

Subsection (b) explains when goods become covered by a certificate of title and when they cease to be covered. Goods may become covered by a certificate of title, even though no certificate of title has issued. Former section 9-103(2)(b) provided that the law of the jurisdiction issuing the certificate ceases to apply upon "surrender" of the certificate. This article eliminates the concept of "surrender." However, if the certificate is surrendered in conjunction with an appropriate application for a certificate to be issued by another jurisdiction, the law of the original jurisdiction ceases to apply because the goods became covered subsequently by a certificate of title from another jurisdiction. Alternatively, the law of the original jurisdiction ceases to apply when the certificate "ceases to be effective" under the law of that jurisdiction. Given the diversity in certificate-of-title statutes, the term "effective" is not defined.

4. **Continued Perfection.** The fact that the law of one state ceases to apply under subsection (b) does not mean that a security interest perfected under that law becomes unperfected automatically. In most cases, the security interest will remain perfected. See section 9-316(d) and (e). Moreover, a perfected security interest may be subject to defeat by certain buyers and secured parties. See section 9-337.

5. **Inventory.** Compliance with a certificate-of-title statute generally is *not* the method of perfecting security interests in inventory. Section 9-311(d) provides that a security interest created in inventory held by a person in the business of selling goods of that kind is subject to the normal filing rules; compliance with a certificate-of-title statute is not necessary or effective to perfect the security interest. Most certificate-of-title statutes are in accord.

The following example explains the subtle relationship between this rule and the choice of law rules in section 9-303 and former section 9-103(2):

Example: Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is "clean"; it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer, who is in the business of selling goods of that kind and is located (within the meaning of section 9-307) in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer's inventory financer, SP, obtains a security interest in the goods under its after-acquired property clause.

Under section 9-311(d) of both State A and State B, Dealer's inventory financer, SP, must perfect by filing instead of complying with a certificate-of-title statute. If section 9-303 were read to provide that the law applicable to perfection of SP's security interest is that of State A, because the goods are covered by a State A certificate, then SP would be required to file in State A under State A's section 9-501. That result would be anomalous, to say the least, since the principle underlying section 9-311(d) is that the inventory should be treated as ordinary goods.

Section 9-303 (and former section 9-103(2)) should be read as providing that the law of State B, not State A, applies. A court looking to the forum's section 9-303(a) would find that section 9-303 applies only if two conditions are met: (i) The goods are covered by the certificate as explained in section 9-303(b), i.e., application had been made for a State (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a "certificate of title" as defined in section 9-102, i.e., "a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor." Stated otherwise, section 9-303 applies only when compliance with a certificate-of-title statute, and not filing, is the appropriate method of perfection. Under the law of State A, *for purposes of perfecting SP's security interest in the dealer's inventory*, the proper method of perfection is filing—not compliance with State A's certificate-of-title statute. For that reason, the goods are not covered by a "certificate of title," and the second condition is not met. Thus, section 9-303 does not apply to the goods. Instead, section 9-301 applies, and the applicable law is that of State B, where the debtor (dealer) is located.

6. **External Constraints on This Section.** The need to coordinate article 9 with a variety of nonuniform certificate-of-title statutes, the need to provide rules to take account of situations in which multiple certificates of title are outstanding with respect to particular goods, and the need to govern the transition from perfection by filing in one jurisdiction to perfection by notation in another all create pressure for a detailed and complex set of rules. In an effort to minimize complexity, this article does not attempt to coordinate article 9 with the entire array of certificate-of-title statutes. In particular, sections 9-303, 9-311, and 9-316(d) and (e) assume that the certificate-of-title statutes to which they apply do not have relation-back provisions (i.e., provisions under which perfection is deemed to occur at a time earlier than when the perfection steps actually are taken). A legislative note to section 9-311 recommends the elimination of relation-back provisions in certificate-of-title statutes affecting perfection of security interests.

Ideally, at any given time, only one certificate of title is outstanding with respect to particular goods. In fact, however, sometimes more than one jurisdiction issues more than one certificate of title with respect to the same goods. This situation results from defects in certificate-of-title laws and the interstate coordination of those laws, not from deficiencies in this article. As long as the possibility of multiple certificates of title remains, the potential for innocent parties to suffer losses will continue. At best, this article can identify clearly which innocent parties will bear the losses in familiar fact patterns.

NORTH CAROLINA COMMENT

At the time of enactment of this Article, G.S. 20-58.2 provides for the relation back of the perfection of a security interest noted on a certificate of title. In the interests of uniformity, this Article has not been amended to address the potential inconsistency highlighted in Official Comment 6, which points out that this Article assumes that certificate-of-title statutes have no relation-back provision. It should be noted that relation back may also be a factor under the federal bankruptcy law.

CASE NOTES

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-304. Law governing perfection and priority of security interests in deposit accounts.

(a) Law of bank's jurisdiction governs. — The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank.

(b) Bank's jurisdiction. — The following rules determine a bank's jurisdiction for purposes of this Part:

(1) If an agreement between the bank and the debtor governing the deposit account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of this Part, this Article, or this Chapter, that jurisdiction is the bank's jurisdiction.

(2) If subdivision (1) of this subsection does not apply and an agreement between the bank and its customer governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(3) If neither subdivision (1) nor subdivision (2) of this subsection applies and an agreement between the bank and its customer governing the deposit account expressly provides that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(4) If none of subdivisions (1), (2), and (3) of this subsection applies, the bank's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the customer's account is located.

(5) If none of subdivisions (1), (2), (3), and (4) of this subsection applies, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; derived from section 8-110(e) and former section 9-103(6).

2. **Deposit Accounts.** Under this section, the law of the "bank's jurisdiction" governs perfection and priority of a security interest in deposit accounts. Subsection (b) contains rules for determining the "bank's jurisdiction." The substance of these rules is substantially similar to that of the rules determining the "security intermediary's jurisdiction" under former section 8-110(e), except that subsection (b)(1) provides more flexibility than the analogous provision in former section 8-110(e)(1). Subsection (b)(1) permits the parties to choose the law of one jurisdiction to govern perfection and priority of security interests and a different governing law for other purposes. The parties' choice is effective, even if the jurisdiction whose law is chosen bears no relationship to the parties or the transaction. Section 8-110(e)(1) has been conformed to subsection (b)(1) of this section, and section 9-305(b)(1), concerning a commodity intermediary's jurisdiction, makes a similar departure from former section 9-103(6)(e)(i).

3. **Change in Law Governing Perfection.** When the bank's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Nevertheless, the change will not result in an immediate loss of perfection. See section 9-316(f) and (g).

§ 25-9-305. Law governing perfection and priority of security interests in investment property.

(a) Governing law: general rules. — Except as otherwise provided in subsection (c) of this section, the following rules apply:

(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or

nonperfection, and the priority of a security interest in the certificated security represented thereby.

(2) The local law of the issuer's jurisdiction as specified in G.S. 25-8-110(d) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.

(3) The local law of the securities intermediary's jurisdiction as specified in G.S. 25-8-110(e) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.

(4) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.

(b) Commodity intermediary's jurisdiction. — The following rules determine a commodity intermediary's jurisdiction for purposes of this Part:

(1) If an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this Part, this Article, or this Chapter, that jurisdiction is the commodity intermediary's jurisdiction.

(2) If subdivision (1) of this subsection does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(3) If neither subdivision (1) nor subdivision (2) of this subsection applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(4) If none of subdivisions (1), (2), and (3) of this subsection applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.

(5) If none of subdivisions (1), (2), (3), and (4) of this subsection applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(c) When perfection governed by law of jurisdiction where debtor located. — The local law of the jurisdiction in which the debtor is located governs:

(1) Perfection of a security interest in investment property by filing;

(2) Automatic perfection of a security interest in investment property created by a broker or securities intermediary; and

(3) Automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-103(6).

2. **Investment Property: General Rules.** This section specifies choice of law rules for perfection and priority of security interests in investment property. Subsection (a)(1) covers security interests in certificated securities. Subsection (a)(2) covers security interests in uncertificated securities. Subsection (a)(3) covers security interests in security entitlements and securities accounts. Subsection (a)(4) covers security interests in commodity contracts and commodity accounts. The approach of each of these paragraphs is essentially the same. They identify the jurisdiction's law that gov-

erns questions of perfection and priority by using the same principles that article 8 uses to determine other questions concerning that form of investment property. Thus, for certificated securities, the law of the jurisdiction in which the certificate is located governs. Cf. section 8-110(c). For uncertificated securities, the law of the issuer's jurisdiction governs. Cf. section 8-110(a). For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. Cf. section 8-110(b). For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Because commodity contracts and commodity accounts are not governed by article 8, subsection (b) contains rules that specify the commodity intermediary's jurisdiction. These are analogous to the rules in section 8-110(e) specifying a securities intermediary's jurisdiction. Subsection (b)(1) affords the parties greater flexibility than did former section 9-103(6)(3). See also section 9-304(b) (bank's jurisdiction) and revised section 8-110(e)(1) (securities intermediary's jurisdiction).

3. **Investment Property: Exceptions.** Subsection (c) establishes an exception to the general rules set out in subsection (a). It provides that perfection of a security interest by filing, automatic perfection of a security interest in investment property created by a debtor who is a broker or securities intermediary (see section 9-309(10)), and automatic perfection of a security interest in a commodity contract or commodity account of a debtor who is a commodity intermediary (see section 9-309(11)) are governed by the law of the jurisdiction in which the debtor is located, as determined under section 9-307.

4. **Examples:** The following examples illustrate the rules in this section:

Example 1: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law but expressly provides that the law of California is Able's jurisdiction for purposes of the Uniform Commercial Code. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a margin loan from Able. Subsection (a)(3) provides that California law—the law of the securities intermediary's jurisdiction—governs perfection and priority of the security interest, even if California has no other relationship to the parties or the transaction.

Example 2: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a loan from a lender located in Illinois. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of section 8-106(d)(2) to give the lender control. Subsection (a)(3) provides that Pennsylvania law-the law of the securities intermediary's jurisdiction-governs perfection and priority of the security interest, even if Pennsylvania has no other relationship to the parties or the transaction.

Example 3: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer borrows from SP-1, and SP-1 files a financing statement in New Jersey. Later, the customer obtains a loan from SP-2. SP-2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of section 8-106(d)(2) to give the SP-2 control. Subsection (c) provides that perfection of SP-1's security interest by filing is governed by the location of the debtor, so the filing in New Jersey was appropriate. Subsection (a)(3), however, provides that Pennsylvania law-the law of the securities intermediary's jurisdiction-governs all other questions of perfection and priority. Thus, Pennsylvania law governs perfection of SP-2's security interest, and Pennsylvania law also governs the priority of the security interests of SP-1 and SP-2.

5. **Change in Law Governing Perfection.** When the issuer's jurisdiction, the securities intermediary's jurisdiction, or commodity intermediary's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Similarly, the law governing perfection of a possessory security interest in a certificated security changes when the collateral is removed to another jurisdiction, see subsection (a)(1), and the law governing perfection by filing changes when the debtor changes its location. See subsection (c). Nevertheless, these changes will not result in an immediate loss of perfection. See section 9-316.

CASE NOTES

Bankruptcy Debtor's Counsel's Retainer. — Under G.S. 25-9-305, a security interest in the debtor's counsel's security retainer fund held in counsel's trust account was perfected due to possession; the monies could be used to pay the approved fees and expenses of counsel nothwithstanding the fact that the debtor's Chapter 11 had been converted to a Chapter 7. In re Carolina Premier Med. Group, P.A., — Bankr. —, 2001 Bankr. LEXIS 1845 (Bankr. M.D.N.C. Aug. 20, 2001).

§ 25-9-306. Law governing perfection and priority of security interests in letter-of-credit rights.

(a) Governing law: issuer's or nominated person's jurisdiction. — Subject to subsection (c) of this section, the local law of the issuer's jurisdiction or a nominated person's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a letter-of-credit right if the issuer's jurisdiction or nominated person's jurisdiction is a state.

(b) Issuer's or nominated person's jurisdiction. — For purposes of this Part, an issuer's jurisdiction or nominated person's jurisdiction is the jurisdiction whose law governs the liability of the issuer or nominated person with respect to the letter-of-credit right as provided in G.S. 25-5-116.

(c) When section not applicable. — This section does not apply to a security interest that is perfected only under G.S. 25-9-308(d). (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; derived in part from section 8-110(e) and former section 9-103(6).

2. ***Sui Generis* Treatment.** This section governs the applicable law for perfection and priority of security interests in letter-of-credit rights, other than a security interest perfected only under section 9-308(d) (i.e., as a supporting obligation). The treatment differs substantially from that provided in section 9-304 for deposit accounts. The basic rule is that the law of the issuer's or nominated person's (e.g., confirmer's) jurisdiction, derived from the terms of the letter of credit itself, controls perfection and priority, but only if the issuer's or nominated person's jurisdiction is a state, as defined in section 9-102. If the issuer's or nominated person's jurisdiction is not a state, the baseline rule of section 9-301 applies—perfection and priority are governed by the law of the debtor's location, determined under section 9-307. Export transactions typically involve a foreign issuer and a domestic nominated person, such as a confirmer, located in a state. The principal goal of this section is to reduce the likelihood that perfection and priority would be governed by the law of a foreign jurisdiction in a transaction that is essentially domestic from the standpoint of the debtor-beneficiary, its creditors, and a domestic nominated person.

3. **Issuer's or Nominated Person's Jurisdiction.** Subsection (b) defers to the rules established under section 5-116 for determination of an issuer's or nominated person's jurisdiction.

Example: An Italian bank issues a letter of credit that is confirmed by a New York bank. The beneficiary is a Connecticut corporation. The letter of credit provides that the issuer's liability is governed by Italian law, and the confirmation provides that the confirmer's liability is governed by the law of New York. Under sections 5-116(a) and 9-306(b), Italy is the issuer's jurisdiction and New York is the confirmer's (nominated person's) jurisdiction. Because the confirmer's jurisdiction is a state, the law of New York governs perfection and priority of a security interest in the beneficiary's letter-of-credit right against the confirmer. See section 9-306(a). However, because the issuer's jurisdiction is not a state, the law of that jurisdiction does not govern. See section 9-306(a). Rather, the choice-of-law rule in section 9-301(1) applies to perfection and priority of a security interest in the beneficiary's letter-of-credit right against the issuer. Under that section, perfection and priority are governed by the law of the jurisdiction in which the debtor (beneficiary) is located. That jurisdiction is Connecticut. See section 9-307.

4. **Scope of this section.** This section specifies only the law governing perfection, the effect of perfection or nonperfection, and priority of security interests. Section 5-116 specifies the law governing the liability of, and article 5

(or other applicable law) deals with the rights and duties of, an issuer or nominated person. Perfection, nonperfection, and priority have no effect on those rights and duties.

5. **Change in Law Governing Perfection.** When the issuer's jurisdiction, or nominated person's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Nevertheless, this change will not result in an immediate loss of perfection. See section 9-316(f) and (g).

§ 25-9-307. Location of debtor.

(a) "Place of business." — In this section, "place of business" means a place where a debtor conducts its affairs.

(b) Debtor's location: general rules. — Except as otherwise provided in this section, the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

(c) Limitation of applicability of subsection (b). — Subsection (b) of this section applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) of this section does not apply, the debtor is located in the District of Columbia.

(d) Continuation of location: cessation of existence, etc. — A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by subsections (b) and (c) of this section.

(e) Location of registered organization organized under state law. — A registered organization that is organized under the law of a state is located in that state.

(f) Location of registered organization organized under federal law; bank branches and agencies. — Except as otherwise provided in subsection (i) of this section, a registered organization that is organized under the law of the United States and a branch or agency of a bank that is not organized under the law of the United States or a state are located:

(1) In the state that the law of the United States designates, if the law designates a state of location;

(2) In the state that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its state of location; or

(3) In the District of Columbia, if neither subdivision (1) nor subdivision (2) of this subsection applies.

(g) Continuation of location: change in status of registered organization. — A registered organization continues to be located in the jurisdiction specified by subsection (e) or (f) of this section notwithstanding:

(1) The suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or

(2) The dissolution, winding up, or cancellation of the existence of the registered organization.

(h) Location of United States. — The United States is located in the District of Columbia.

(i) Location of foreign bank branch or agency if licensed in only one state. — A branch or agency of a bank that is not organized under the law of the United States or a state is located in the state in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one state.

(j) Location of foreign air carrier. — A foreign air carrier under the Federal Aviation Act of 1958, as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(k) Section applies only to this Part. — This section applies only for purposes of this Part. (2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former section 9-103(3)(d), substantially revised.

2. **General Rules.** As a general matter, the location of the debtor determines the jurisdiction whose law governs perfection of a security interest. See sections 9-301(1) and 9-305(c). It also governs priority of a security interest in certain types of intangible collateral, such as accounts, electronic chattel paper, and general intangibles. This section determines the location of the debtor for choice of law purposes, but not for other purposes. See subsection (k).

Subsection (b) states the general rules: An individual debtor is deemed to be located at the individual's principal residence with respect to both personal and business assets. Any other debtor is deemed to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business.

As used in this section, a "place of business" means a place where the debtor conducts its affairs. See subsection (a). Thus, every organization, even eleemosynary institutions and other organizations that do not conduct "for profit" business activities, has a "place of business." Under subsection (d), a person who ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction determined by subsection (b).

The term "chief executive office" is not defined in this section or elsewhere in the Uniform Commercial Code. "Chief executive office" means the place from which the debtor manages the main part of its business operations or other affairs. This is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. With respect to most multistate debtors, it will be simple to determine which of the debtor's offices is the "chief executive office." Even when a doubt arises, it would be rare that there could be more than two possibilities. A secured party in such a case may protect itself by perfecting under the law of each possible jurisdiction.

Similarly, the term "principal residence" is not defined. If the security interest in question is a purchase-money security interest in consumer goods which is perfected upon attachment, see section 9-309(1), the choice of law may make no difference. In other cases, when a doubt arises, prudence may dictate perfecting under the law of each jurisdiction that might be the debtor's "principal residence."

The general rule is subject to several exceptions, each of which is discussed below.

3. **Non-U.S. Debtors.** Under the general rules of this section, a non-U.S. debtor normally would be located in a foreign jurisdiction and, as a consequence, foreign law would govern perfection. When foreign law affords no public notice of security interests, the general rule yields unacceptable results.

Accordingly, subsection (c) provides that the normal rules for determining the location of a debtor (i.e., the rules in subsection (b)) apply only if they yield a location that is "a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral." The phrase "generally requires" is meant to include legal regimes that generally require notice in a filing or recording system as a condition of perfecting nonpossessory security interests, but which permit perfection by another method (e.g., control, automatic perfection, temporary perfection) in limited circumstances. A jurisdiction that has adopted this article or an earlier version of this article is such a jurisdiction. If the rules in subsection (b) yield a jurisdiction whose law does not generally require notice in a filing or registration system, the debtor is located in the District of Columbia.

Example 1: Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in its accounts. Under subsection (b)(3), Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law generally conditions perfection on giving public notice in a filing, recording, or registration system. Otherwise, Debtor is located in the District of Columbia. Under section 9-301(1), perfection, the effect of perfection, and priority are governed by the law of the jurisdiction of the debtor's location—here, England or the District of Columbia (depending on the content of English law).

Example 2: Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in equipment located in London. Under subsection (b)(3) Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law generally conditions perfection on giving public notice in a filing, recording, or registration system. Otherwise, Debtor is located in the District of Columbia. Under section 9-301(1), perfection is governed by the law of the jurisdiction of the debtor's location, whereas, under section 9-301(3), the law of the jurisdiction in which the collateral is located—here, England—governs priority.

The foregoing discussion assumes that each transaction bears an appropriate relation to the forum state. In the absence of an appropriate relation, the forum state's entire UCC, including the choice of law provisions in article 9 (sections 9-301 through 9-307), will not apply. See section 9-109, comment 9.

4. **Registered Organizations Organized Under Law of a State.** Under subsection (e), a registered organization (e.g., a corporation or limited partnership) organized under the law of a "state" (defined in section 9-102) is located in its state of organization. Subsection (g) makes clear that events affecting the status of a registered organization, such as the dissolution of a corporation or revocation of its charter, do not affect its location for purposes of subsection (e). However, certain of these events may result in, or be accompanied by, a transfer of collateral from the registered organization to another debtor. This section does not determine whether a transfer occurs, nor does it determine the legal consequences of any transfer.

Determining the registered organization-debtor's location by reference to the jurisdiction of organization could provide some important side benefits for the filing systems. A jurisdiction could structure its filing system so that it would be impossible to make a mistake in a registered organization-debtor's name on a financing statement. For example, a filer would be informed if a filed record designated an incorrect corporate name for the debtor. Linking filing to the jurisdiction of organization also could reduce pressure on the system imposed by transactions in which registered organizations cease to exist—as a consequence of merger or consolidation, for example. The jurisdiction of organization might prohibit such transactions unless steps were taken to ensure that existing filings were refiled against a successor or terminated by the secured party.

5. **Registered Organizations Organized Under Law of United States;** Branches and Agencies of Banks Not Organized Under Law of United States. Subsection (f) specifies the location of a debtor that is a registered organization organized under the law of the United States. It defers to the law of the United States, to the extent that that law determines, or authorizes the debtor to determine, the debtor's location. Thus, if the law of the United States designates a particular state as the debtor's location, that state is the debtor's location for purposes of this article's choice of law rules. Similarly, if the law of the United States authorizes the registered organization to designate its state of location, the state that the registered organization designates is the state in which it is located for purposes of this article's choice of law rules. In other cases, the debtor is located in the District of Columbia.

In some cases, the law of the United States authorizes the registered organi-zation to designate a main office, home office, or other comparable office. See, e.g., 12 U.S.C. §§ 22 and 1464(a); 12 C.F.R. § 552.3. Designation of such an office constitutes the designation of the State of location for purposes of Section 9-307(f)(2).

Subsection (f) also specifies the location of a branch or agency in the United States of a foreign bank that has one or more branches or agencies in the United States. The law of the United States authorizes a foreign bank (or, on behalf of the bank, a federal regulatory agency) to designate a single home state for all of the foreign bank's branches and agencies in the United States. See 12 U.S.C. § 3103(c) and 12 C.F.R. § 211.22. The designated State constitutes the State of location for the branch or agency for purposes of Section 9-307(f): however if all of the foreign bank's branches or agencies that are in the United States are licensed in only one State, the branches and agencies are located in that State. See subsection (i).

In cases not governed by subsection (f) or (i), the location of a foreign bank is determined by subsections (b) and (c).

6. **United States.** To the extent that article 9 governs (see sections 1-105 and 9-109(c)), the United States is located in the District of Columbia for purposes of this article's choice of law rules. See subsection (h).

7. **Foreign Air Carriers.** Subsection (j) follows former section 9-103(3)(d). To the extent that it is applicable, the Convention on the International Recognition of Rights in Aircraft (Geneva Convention) supersedes state legislation on this subject, as set forth in section 9-311(b), but some nations are not parties to that convention.

CASE NOTES

Applied in In re Augusta Tissue Mill, LLC, — Bankr. —, 2007 Bankr. LEXIS 3040 (Bankr. M.D.N.C. Sept. 5, 2007).

Subpart 2. Perfection.

§ 25-9-308. When security interest or agricultural lien is perfected; continuity of perfection.

(a) Perfection of security interest. — Except as otherwise provided in this section and G.S. 25-9-309, a security interest is perfected if it has attached and all of the applicable requirements for perfection in G.S. 25-9-310 through G.S. 25-9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

(b) Perfection of agricultural lien. — An agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in G.S. 25-9-310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective.

(c) Continuous perfection; perfection by different methods. — A security interest or agricultural lien is perfected continuously if it is originally perfected by one method under this Article and is later perfected by another method under this Article, without an intermediate period when it was unperfected.

(d) Supporting obligation. — Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.

(e) Lien securing right to payment. — Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.

(f) Security entitlement carried in securities account. — Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

(g) Commodity contract carried in commodity account. — Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account. (1997-181, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-115(2) and 9-303.

2. **General Rule.** This article uses the term "attach" to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in section 9-203. When it attaches, a security interest may be either perfected or unperfected. "Perfected" means that the security interest has attached and the secured party has taken all the steps required by this article as specified in sections 9-310 through 9-316. A perfected security interest may still be or become subordinate to other interests. See, e.g., sections 9-320 and 9-322. However, in general, after perfection the secured party is protected against creditors and transferees of the debtor and, in particular, against any representative of creditors in insolvency proceedings instituted by or against the debtor. See, e.g., section 9-317.

Subsection (a) explains that the time of perfection is when the security interest has attached and any necessary steps for perfection, such as taking possession or filing, have been taken. The "except" clause refers to the perfection-upon-attachment rules appearing in section 9-309. It also reflects that other subsections of this section, e.g., subsection (d), contain automatic perfection rules. If the steps for perfection have been taken in advance, as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral, then the security interest is perfected when it attaches.

3. **Agricultural Liens.** Subsection (b) is new. It describes the elements of perfection of an agricultural lien.

4. **Continuous Perfection.** The following example illustrates the operation of subsection (c):

Example 1: Debtor, an importer, creates a security interest in goods that it imports and the documents of title that cover the goods. The secured party, Bank, takes possession of a negotiable bill of lading covering certain imported goods and thereby perfects its security interest in the bill of lading and the goods. See sections 9-312(c)(1) and 9-313(a). Bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them. Under section 9-312(f), Bank continues to have a perfected security interest in the document and goods for 20 days. Bank files a financing statement covering the collateral before the expiration of the 20-day period. Its security interest now continues perfected for as long as the filing is good.

If the successive stages of Bank's security interest succeed each other without an intervening gap, the security interest is "perfected continuously," and the date of perfection is when the security interest first became perfected (i.e., when Bank received possession of the bill of lading). If, however, there is a gap between stages—for example, if Bank does not file until after the expiration of the 20-day period specified in section 9-312(f) and leaves the collateral in the debtor's possession—then, the chain being broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of the 20-day period). Bank's security interest would be vulnerable to any interests arising during the gap period which under section 9-317 take priority over an unperfected security interest.

5. **Supporting Obligations.** Subsection (d) is new. It provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected. This is unlikely to effect any change in the law prior to adoption of this article.

Example 2: Buyer is obligated to pay Debtor for goods sold. Buyer's president guarantees the obligation. Debtor creates a security interest in the right to payment (account) in favor of Lender. Under section 9-203(f), the security interest attaches to Debtor's rights under the guarantee (supporting obligation). Under subsection (d), perfection of the security interest in the account constitutes perfection of the security interest in Debtor's rights under the guarantee.

6. **Rights to Payment Secured by Lien.** Subsection (e) is new. It deals with the situation in which a security interest is created in a right to payment that is secured by a security interest, mortgage, or other lien.

Example 3: Owner gives to Mortgagee a mortgage on Blackacre to secure a loan. Owner's obligation to pay is evidenced by a promissory note. In need of working capital, Mortgagee borrows from Financer and creates a security interest in the note in favor of Financer. Section 9-203(g) adopts the traditional view that the mortgage follows the note; i.e., the transferee of the note acquires the mortgage, as well. This subsection adopts a similar principle: Perfection of a security interest in the right to payment constitutes perfection of a security interest in the mortgage securing it.

An important consequence of the rules in section 9-203(g) and subsection (e) is that, by acquiring a perfected security interest in a mortgage (or other secured) note, the secured party acquires a security interest in the mortgage (or other lien) that is senior to the rights of a person who becomes a lien creditor of the mortgagee (article 9 debtor). See section 9-317(a)(2). This result helps prevent the separation of the mortgage (or other lien) from the note.

Under this article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then article 3 dictates the person whom the maker must pay to discharge the note and any lien securing it. See section 3-602. If the right to payment is a payment intangible, then section 9-406 determines whom the account debtor must pay.

Similarly, this article does not determine who has the power to release a mortgage of record. That issue is determined by real property law.

7. **Investment Property.** Subsections (f) and (g) follow former section 9-115(2).

Legal Periodicals. — For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For 1997 legislative survey, see 20 Campbell L. Rev. 401.

CASE NOTES

***Editor's Note.** — The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Filing of Financing Statement Only One Step in Creating Security Interest. — Since a financing statement may be filed for reasons other than the perfection of an existing security interest, the filing of a financing statement alone is not enough to create a security interest; it is but one step by which the rights and priorities of a secured party are perfected. In re Murray Bros., 53 Bankr. 281 (Bankr. E.D.N.C. 1985).

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-309. Security interest perfected upon attachment.

The following security interests are perfected when they attach:

(1) A purchase-money security interest in consumer goods, except as otherwise provided in G.S. 25-9-311(b) with respect to consumer goods that are subject to a statute or treaty described in G.S. 25-9-311(a);

(2) An assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;

(3) A sale of a payment intangible;

(4) A sale of a promissory note;

(5) A security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services;

(6) A security interest arising under G.S. 25-2-401, 25-2-505, 25-2-711(3), or 25-2A-508(5), until the debtor obtains possession of the collateral;

(7) A security interest of a collecting bank arising under G.S. 25-4-208;

(8) A security interest of an issuer or nominated person arising under G.S. 25-5-118;

(9) A security interest arising in the delivery of a financial asset under G.S. 25-9-206(c);

(10) A security interest in investment property created by a broker or securities intermediary;

(11) A security interest in a commodity contract or a commodity account created by a commodity intermediary;

(12) An assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder; and

(13) A security interest created by an assignment of a beneficial interest in a decedent's estate. (1997-181, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Derived from former sections 9-115(4)(c) and (d), 9-116, and 9-302(1).

2. **Automatic Perfection.** This section contains the perfection-upon-attachment rules previously located in former sections 9-115(4)(c) and (d), 9-116, and 9-302(1). Rather than continue to state the rule by indirection, this section explicitly provides for perfection upon attachment.

3. **Purchase-Money Security Interest in Consumer Goods.** Former section 9-302(1)(d) has been revised and appears here as paragraph (1). No filing or other step is required to perfect a purchase-money security interest in

consumer goods, other than goods, such as automobiles, that are subject to a statute or treaty described in section 9-311(a). However, filing is required to perfect a non-purchase-money security interest in consumer goods and is necessary to prevent a buyer of consumer goods from taking free of a security interest under section 9-320(b). A fixture filing is required for priority over conflicting interests in fixtures to the extent provided in section 9-334.

4. **Rights to Payment.** Paragraph (2) expands upon former section 9-302(1)(e) by affording automatic perfection to certain assignments of payment intangibles as well as accounts. The purpose of paragraph (2) is to save from ex post facto invalidation casual or isolated assignments—assignments which no one would think of filing. Any person who regularly takes assignments of any debtor's accounts or payment intangibles should file. In this connection section 9-109(d)(4) through (7), which excludes certain transfers of accounts, chattel paper, payment intangibles, and promissory notes from this article, should be consulted.

Paragraphs (3) and (4), which are new, afford automatic perfection to sales of payment intangibles and promissory notes, respectively. They reflect the practice under former article 9. Under that article, filing a financing statement did not affect the rights of a buyer of payment intangibles or promissory notes, inasmuch as the former article did not cover those sales. To the extent that the exception in paragraph (2) covers outright sales of payment intangibles, which automatically are perfected under paragraph (3), the exception is redundant.

5. **Health-Care-Insurance Receivables.** Paragraph (5) extends automatic perfection to assignments of health-care-insurance receivables if the assignment is made to the health-care provider that provided the health-care goods or services. The primary effect is that, when an individual assigns a right to payment under an insurance policy to the person who provided health-care goods or services, the provider has no need to file a financing statement against the individual. The normal filing requirements apply to other assignments of health-care-insurance receivables covered by this article, e.g., assignments from the health-care provider to a financer.

6. **Investment Property.** Paragraph (9) replaces the last clause of former section 9-116(2), concerning security interests that arise in the delivery of a financial asset.

Paragraphs (10) and (11) replace former section 9-115(4)(c) and (d), concerning secured financing of securities and commodity firms and clearing corporations. The former sections indicated that, with respect to certain security interests created by a securities intermediary or commodity intermediary, "(t)he filing of a financing statement . . . has no effect for purposes of perfection or priority with respect to that security interest." No change in meaning is intended by the deletion of the quoted phrase.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances, lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this article are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. See sections 8-106, 9-106, and 9-314. Noncontrol secured financing arrangements for securities firms are covered by the automatic perfection rule of paragraph (10). Before the 1994 revision of articles 8 and 9, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The automatic-perfection rule of paragraph (10) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top-tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in section 8-102(a)(14) to include clearing corporations. Thus, the perfection rule of paragraph (10) applies to security interests in investment property granted by clearing corporations.

7. **Beneficial Interests in Trusts.** Under former section 9-302(1)(c), filing was not required to perfect a security interest created by an assignment of a beneficial interest in a trust. Because beneficial interests in trusts are now used as collateral with greater frequency in commercial transactions, under this article filing is required to perfect a security interest in a beneficial interest.

8. **Assignments for Benefit of Creditors.** No filing or other action is required to perfect an assignment for the benefit of creditors. These assignments are not financing transactions, and the debtor ordinarily will not be engaging in further credit transactions.

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Security Interest in Mobile Home Affixed to Real Property. — Plaintiff's argument that owner no longer intended to operate her mobile home upon the highway did not nullify defendant's properly perfected security interest in the mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A perfected lien noted on the certificate of title remains superior despite the annexation of the mobile home to realty. Hughes v. Young, 115 N.C. App. 325, 444 S.E.2d 248 (1994).

Once the title certificate has been issued for a mobile home and a creditor has perfected a lien upon the mobile home by registering its lien on the title certificate, the mobile home does not lose its status as a mobile home merely because the owner thereafter permanently affixes it to the land; therefore, the secured creditor with a lien on the title prevails over a subsequent creditor who takes a deed of trust on the land and mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A mobile home is a motor vehicle, and is subject to the mandatory provisions of the statutes relating to the registration of motor vehicles in this State. King Homes, Inc. v. Bryson, 273 N.C. 84, 159 S.E.2d 329 (1968).

Vehicle "Required to be Registered." — A vehicle is "required to be registered" only if the owner intends to operate it on state highways and only if the vehicle is not exempt from statutory registration requirements; both of these disjunctive requirements must be met before the vehicle is "required to be registered." Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

When Mobile Home is Not Vehicle. — Where a duly licensed mobile home dealer purchased a doublewide from the manufacturer and attached it to a fixed, permanent foundation before transferring the lot and doublewide to the transferee, and the parties did not intend for the doublewide to be operated upon the highways, there was no requirement that the doublewide be registered or that a certificate of title be obtained by either party. In re Meade, 174 Bankr. 49 (Bankr. M.D.N.C. 1994).

Mobile home was not a motor vehicle "required to be registered," where it was permanently affixed to real estate and the owner had no intention to operate it on highways; thus, the creditor properly perfected his interest by recording a deed of trust for the real estate to which the mobile home was affixed. Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

§ 25-9-310. When filing required to perfect security interest or agricultural lien; security interests and agricultural liens to which filing provisions do not apply.

(a) General rule: perfection by filing. — Except as otherwise provided in subsection (b) of this section and G.S. 25-9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.

(b) Exceptions: filing not necessary. — The filing of a financing statement is not necessary to perfect a security interest:

(1) That is perfected under G.S. 25-9-308(d), (e), (f), or (g);

(2) That is perfected under G.S. 25-9-309 when it attaches;

(3) In property subject to a statute, regulation, or treaty described in G.S. 25-9-311(a);

(4) In goods in possession of a bailee which is perfected under G.S. 25-9-312(d)(1) or (2);

(5) In certificated securities, documents, goods, or instruments which is perfected without filing, control, or possession under G.S. 25-9-312(e), (f), or (g);

(6) In collateral in the secured party's possession under G.S. 25-9-313;

(7) In a certificated security which is perfected by delivery of the security certificate to the secured party under G.S. 25-9-313;

(8) In deposit accounts, electronic chattel paper, electronic documents, investment property, or letter-of-credit rights which is perfected by control under G.S. 25-9-314;

(9) In proceeds which is perfected under G.S. 25-9-315; or

(10) That is perfected under G.S. 25-9-316.

(c) Assignment of perfected security interest. — If a secured party assigns a perfected security interest or agricultural lien, a filing under this Article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor. (1866-7, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1977, c. 103; 1989 (Reg. Sess., 1990), c. 1024, s. 8(i); 1997-181, s. 92000-169, s. 1; 2001-218, s. 3; 2001-487, s. 57; 2006-112, s. 49.)

OFFICIAL COMMENT

1. **Source.** Former section 9-302(1), (2).

2. **General Rule.** Subsection (a) establishes a central article 9 principle: Filing a financing statement is necessary for perfection of security interests and agricultural liens. However, filing is not necessary to perfect a security interest that is perfected by another permissible method, see subsection (b), nor does filing ordinarily perfect a security interest in a deposit account, letter-of-credit right, or money. See section 9-312(b). Part 5 of the article deals with the office in which to file, mechanics of filing, and operations of the filing office.

3. **Exemptions from Filing.** Subsection (b) lists the security interests for which filing is not required as a condition of perfection, because they are perfected automatically upon attachment (subsections (b)(2) and (b)(9)) or upon the occurrence of another event (subsections (b)(1), (b)(5), and (b)(9)), because they are perfected under the law of another jurisdiction (subsection (b)(10)), or because they are perfected by another method, such as by the secured party's taking possession or control (subsections (b)(3), (b)(4), (b)(5), (b)(6), (b)(7), and (b)(8)).

4. **Assignments of Perfected Security Interests.** Subsection (c) concerns assignment of a perfected security interest or agricultural lien. It provides that no filing is necessary in connection with an assignment by a secured party to an assignee in order to maintain perfection as against creditors of and transferees from the original debtor.

Example 1: Buyer buys goods from Seller, who retains a security interest in them. After Seller perfects the security interest by filing, Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on X's part, continues perfected against Buyer's transferees and creditors.

Example 2: Dealer creates a security interest in specific equipment in favor of Lender. After Lender perfects the security interest in the equipment by filing, Lender assigns the chattel paper (which includes the perfected security interest in Dealer's equipment) to X. The security interest in the equipment, in X's hands and without further steps on X's part, continues perfected against Dealer's transferees and creditors. However, regardless of whether Lender made the assignment to secure Lender's obligation to X or whether the assignment was an outright sale of the chattel paper, the assignment creates a security interest in the chattel paper in favor of X. Accordingly, X must take whatever steps may be required for perfection in order to be protected against Lender's transferees and creditors with respect to the chattel paper.

Subsection (c) applies not only to an assignment of a security interest perfected by filing but also to an assignment of a security interest perfected by a method other than by filing, such as by control or by possession. Although subsection (c) addresses explicitly only the absence of an additional filing requirement, the same result normally will follow in the case of an assignment of a security interest perfected by a method other than by filing. For example, as long as possession of collateral is maintained by an assignee or by the assignor or another person on behalf of the assignee, no further perfection steps need be taken on account of the assignment to continue perfection as against creditors and transferees of the original debtor. Of course, additional action may be required for perfection of the assignee's interest as against creditors and transferees of the assignor.

Similarly, subsection (c) applies to the assignment of a security interest perfected by compliance with a statute, regulation, or treaty under section 9-311(b), such as a certificate-of-title statute. Unless the statute expressly provides to the contrary, the security interest will remain perfected against creditors of and transferees from the original debtor, even if the assignee takes no action to cause the certificate of title to reflect the assignment or to cause its name to appear on the certificate of title. See PEB Commentary No. 12, which discusses this issue under former section 9-302(3). Compliance with the statute is "equivalent to filing" under section 9-311(b).

Cross References. — As to authorization for consumer finance licensee under the North Carolina Consumer Finance Act, G.S. 53-164 et seq., to collect from borrower recording fees required pursuant to this Article, see G.S. 53-177.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 49, effective October 1, 2006, inserted "control," in subdivision (b)(5); inserted "electronic documents," in subdivision (b)(8); and inserted "G.S." in subdivision (b)(10).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

A financing statement need not be filed to perfect a security interest in collateral which is in the possession of the secured party. Gray v. Giant Whsle. Corp., 758 F.2d 1000 (4th Cir. 1985).

The requirement of perfection of security interests is relevant only to third-party priority claims and not to disputes between the secured party and the debtor. Mazda Motors of Am., Inc. v. Southwestern Motors, Inc., 36 N.C. App. 1, 243 S.E.2d 793 (1978), aff'd in part, rev'd in part on other grounds, 296 N.C. 357, 250 S.E.2d 250 (1979).

Application of Provisions as to Place for Filing Financing Statements. — Provisions of the UCC with reference to the place for filing financing statements have no application to vehicles subject to registration with the Department of Motor Vehicles. Ferguson v. Morgan, 282 N.C. 83, 191 S.E.2d 817 (1972).

When Mobile Home is Not Vehicle. — Mobile home was not a motor vehicle "required to be registered," where it was permanently affixed to real estate and the owner had no intention to operate it on highways; thus, the creditor properly perfected his interest by recording a deed of trust for the real estate to which the mobile home was affixed. Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

Financing Statement Not Required. — Where defendant purchased a VCR from plaintiff and, he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-311. Perfection of security interests in property subject to certain statutes, regulations, and treaties.

(a) Security interest subject to other law. — Except as otherwise provided in subsection (d) of this section, the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

(1) A statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt G.S. 25-9-310(a);

(2) A certificate-of-title statute of this State covering automobiles or other goods that provides for a security interest to be indicated on the certificate as a condition to or result of perfection of the security interest, including G.S. 20-58 and G.S. 75A-41; or

(3) A certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

(b) Compliance with other law. — Compliance with the requirements of a statute, regulation, or treaty described in subsection (a) of this section for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this Article. Except as otherwise provided in subsection (d) of this section and G.S. 25-9-313 and G.S. 25-9-316(d) and (e) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (a) of this section may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

(c) Duration and renewal of perfection. — Except as otherwise provided in subsection (d) of this section and G.S. 25-9-316(d) and (e), duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (a) of this section are governed by the statute, regulation, or treaty. In other respects, the security interest is subject to this Article.

(d) Inapplicability to certain inventory. — During any period in which collateral subject to a statute specified in subdivision (a)(2) of this section is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person. (1866-7, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1977, c. 103; 1989 (Reg. Sess., 1990), c. 1024, s. 8(i); 1997-181, s. 9; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-302(3), (4).

2. **Federal Statutes, Regulations, and Treaties.** Subsection (a)(1) exempts from the filing provisions of this article transactions as to which a system of filing—state or federal—has been established under federal law. Subsection (b) makes clear that when such a system exists, perfection of a relevant security interest can be achieved only through compliance with that system (i.e., filing under this article is not a permissible alternative).

An example of the type of federal statute referred to in subsection (a)(1) is 49 U.S.C. sections 44107-11, for civil aircraft of the United States. The Assignment of Claims Act of 1940, as amended, provides for notice to contracting and disbursing officers and to sureties on bonds but does not establish a national filing system and therefore is not within the scope of subsection (a)(1). An assignee of a claim against the United States may benefit from compliance with the Assignment of Claims Act. But regardless of whether the assignee complies with that act, the assignee must file under this article in order to perfect its security interest against creditors and transferees of its assignor.

Subsection (a)(1) provides explicitly that the filing requirement of this article defers only to federal statutes, regulations, or treaties whose requirements for a security interest's obtaining priority over the rights of a lien creditor preempt section 9-310(a). The provision eschews reference to the term "perfection," inasmuch as section 9-308 specifies the meaning of that term and a preemptive rule may use other terminology.

3. **State Statutes.** Subsections (a)(2) and (3) exempt from the filing requirements of this article transactions covered by state certificate-of-title statutes covering motor vehicles and the like. The description of certificate-of-title statutes in subsections (a)(2) and (a)(3) tracks the language of the definition of "certificate of title" in section 9-102. For a discussion of the operation of state certificate-of-title statutes in interstate contexts, see the comments to section 9-303.

Some states have enacted central filing statutes with respect to secured transactions in kinds of property that are of special importance in the local economy. Subsection (a)(2) defers to these statutes with respect to filing for that property.

4. **Inventory Covered by Certificate of Title.** Under subsection (d), perfection of a security interest in the inventory of a person in the business of selling goods of that kind is governed by the normal perfection rules, even if the inventory is subject to a certificate-of-title statute. Compliance with a certificate-of-title statute is both unnecessary and ineffective to perfect a security interest in inventory to which this subsection applies. Thus, a secured party who finances an automobile dealer that is in the business of selling and leasing its inventory of automobiles can perfect a security interest in all the automobiles by filing a financing statement but not by compliance with a certificate-of-title statute.

Subsection (d), and thus the filing and other perfection provisions of this Article, does not apply to inventory that is subject to a certificate-of-title statute and is of a kind that the debtor is not in the business of selling. For example, if goods are subject to a certificate-of-title statute and the debtor is in the business of leasing but not of selling, goods of that kind, the other subsections of this section govern perfection of a security interest in the goods. The fact that the debtor eventually sells the goods does not, of itself, mean that the debtor "is in the business of selling goods of that kind."

The filing and other perfection provisions of this Article apply to goods subject to a certificate-of-title statute only "during any period in which collateral is inventory held for sale or lease or leased." If the debtor takes goods of this kind out of inventory and uses them, say, as equipment, a filed financing statement would not remain effective to perfect a security interest.

5. **Compliance with Perfection Requirements of Other Statute.** Subsection (b) makes clear that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not

other requirements, of a statute, regulation, or treaty described in subsection (a), is sufficient for perfection under this article. Perfection of a security interest under such a statute, regulation, or treaty has all the consequences of perfection under this article.

The interplay of this section with certain certificate-of-title statutes may create confusion and uncertainty. For example, statutes under which perfection does not occur until a certificate of title is issued will create a gap between the time that the goods are covered by the certificate under section 9-303 and the time of perfection. If the gap is long enough, it may result in turning some unobjectionable transactions into avoidable preferences under Bankruptcy Code section 547. (The preference risk arises if more than 10 days (or 20 days, in the case of a purchase-money security interest) passes between the time a security interest attaches (or the debtor receives possession of the collateral, in the case of a purchase-money security interest) and the time it is perfected.) Accordingly, the legislative note to this section instructs the legislature to amend the applicable certificate-of-title statute to provide that perfection occurs upon receipt by the appropriate state official of a properly tendered application for a certificate of title on which the security interest is to be indicated.

Under some certificate-of-title statutes, including the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, perfection generally occurs upon delivery of specified documents to a state official but may, under certain circumstances, relate back to the time of attachment. This relation-back feature can create great difficulties for the application of the rules in sections 9-303 and 9-311(b). Accordingly, the legislative note also recommends to legislatures that they remove any relation-back provisions from certificate-of-title statutes affecting security interests.

6. **Compliance with Perfection Requirements of Other Statute as Equivalent to Filing.** Under subsection (b), compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor) of a statute, regulation, or treaty described in subsection (a) "is equivalent to the filing of a financing statement."

The quoted phrase appeared in former section 9-302(3). Its meaning was unclear, and many questions arose concerning the extent to which and manner in which article 9 rules referring to "filing" were applicable to perfection by compliance with a certificate-of-title statute. This article takes a variety of approaches for applying article 9's filing rules to compliance with other statutes and treaties. First, as discussed above in comment 5, it leaves the determination of some rules, such as the rule establishing time of perfection (section 9-516(a)), to the other statutes themselves. Second, this article explicitly applies some article 9 filing rules to perfection under other statutes or treaties. See, e.g., section 9-505. Third, this article makes other article 9 rules applicable to security interests perfected by compliance with another statute through the "equivalent to . . . filing" provision in the first sentence of section 9-311(b). The third approach is reflected for the most part in occasional comments explaining how particular rules apply when perfection is accomplished under section 9-311(b). See, e.g., section 9-310, comment 4; section 9-315, comment 6; and section 9-317, comment 8. The absence of a comment indicating that a particular filing provision applies to perfection pursuant to section 9-311(b) does not mean the provision is inapplicable.

7. **Perfection by Possession of Goods Covered by Certificate-of-Title Statute.** A secured party who holds a security interest perfected under the law of State A in goods that subsequently are covered by a State B certificate of title may face a predicament. Ordinarily, the secured party will have four months under State B's section 9-316(c) and (d) in which to (re)perfect as against a purchaser of the goods by having its security interest noted on a State B certificate. This procedure is likely to require the cooperation of the debtor and any competing secured party whose security interest has been noted on the certificate. Comment 4(e) to former section 9-103 observed that "that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party." According to that comment, "(t)he only solution for the out-of-state secured party under present certificate of title statutes seems to be to reperfect by possession, i.e., by repossessing the goods." But the "solution" may not have worked: Former section 9-302(4) provided that a security interest in property subject to a certificate-of-title statute "can be perfected only by compliance therewith."

Sections 9-311(c), 9-313(b), and 9-316(d) and (e) of this article resolve the conflict by providing that a security interest that remains perfected solely by virtue of section 9-316(e) can be (re)perfected by the secured party's taking possession of the collateral. These sections contemplate only that taking possession of goods covered by a certificate of title will work as a method of perfection. None of these sections creates a right to take possession. Section 9-609 and the agreement of the parties define the secured party's right to take possession.

NORTH CAROLINA COMMENT

Under North Carolina law, manufactured homes may be deemed to be motor vehicles (see G.S. 20-50) and subject to the laws governing motor vehicles with respect to the perfection of security interests in them or to be an improvement to real property or real property (see G.S. 47-20.6 and G.S. 47-20.7) and subject to the laws governing real property with respect to the perfection of security interests in them.

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Vehicle "Required to be Registered." — A vehicle is "required to be registered" only if the owner intends to operate it on state highways and only if the vehicle is not exempt from statutory registration requirements; both of these disjunctive requirements must be met before the vehicle is "required to be registered." Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

Article Inapplicable to Motor Vehicles Unless Held as Inventory. — The provisions of Article 9 of the UCC pertaining to the filing, perfection and priority of security interests do not apply to a security interest in any personal property required to be registered pursuant to Chapter 20, relating to motor vehicles, unless such property is held as inventory and the security is created by the inventory seller. Bank of Alamance v. Isley, 74 N.C. App. 489, 328 S.E.2d 867 (1985).

Article 9 does not apply to security interests in motor vehicles unless they are held as inventory and the security is created by the inventory seller. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

With reference to vehicles subject to registration with the Division of Motor Vehicles, the provisions of G.S. 20-58 et seq. are the exclusive statutory authority governing the perfecting of security interests in motor vehicles. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

Sale of Automobile Subject to § 20-58 et seq. — Once a sale of an automobile has occurred contemplating regular use, whether it be a sale of a complete or limited interest, the vehicle is then subject to North Carolina's certificate of title statute, G.S. 20-58 et seq. Bank of Alamance v. Isley, 74 N.C. App. 489, 328 S.E.2d 867 (1985).

A car held in inventory by a used car business fell within the provisions of G.S. 20-58.8(b)(3) and former G.S. 25-9-30(3)(b). North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

A security interest in a mobile home is subject to the same perfection requirements as an automobile. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Based on the language of G.S. 20-58 et seq., the legislature intended that this statute provide the exclusive method for a first mortgagee to perfect a security interest in a mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

Plaintiff's argument that owner no longer intended to operate her mobile home upon the highway did not nullify defendant's properly perfected security interest in the mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A perfected lien noted on the certificate of title remains superior despite the annexation of the mobile home to realty. Hughes v. Young, 115 N.C. App. 325, 444 S.E.2d 248 (1994).

Once the title certificate has been issued for a mobile home and a creditor has perfected a lien upon the mobile home by registering its lien on the title certificate, the mobile home does not lose its status as a mobile home merely because the owner thereafter permanently affixes it to the land; therefore, the secured creditor with a lien on the title prevails over a subsequent creditor who takes a deed of trust on the land and mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A mobile home is a motor vehicle, and is subject to the mandatory provisions of the statutes relating to the registration of motor vehicles in this State. King Homes, Inc. v. Bryson, 273 N.C. 84, 159 S.E.2d 329 (1968).

When Mobile Home is Not Vehicle. — Mobile home was not a motor vehicle "required to be registered," where it was permanently affixed to real estate and the owner had no intention to operate it on highways; thus, the creditor properly perfected his interest by recording a deed of trust for the real estate to which the mobile home was affixed. Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

Where a duly licensed mobile home dealer purchased a doublewide from the manufacturer and attached it to a fixed, permanent foundation before transferring the lot and doublewide to the transferee, and the parties did not intend for the doublewide to be operated upon the highways, there was no requirement that the doublewide be registered or that a certificate of title be obtained by either party. In re Meade, 174 Bankr. 49 (Bankr. M.D.N.C. 1994).

OPINIONS OF ATTORNEY GENERAL

Perfection of Security Interest in Motor Vehicle. — See opinion of Attorney General to Mr. Eric L. Gooch, Director, Sales and Use Tax Division, N.C. Department of Revenue, 40 N.C.A.G. 446 (1969).

§ 25-9-312. Perfection of security interests in chattel paper, deposit accounts, documents, goods covered by documents, instruments, investment property, letter-of-credit rights, and money; perfection by permissive filing; temporary perfection without filing or transfer of possession.

(a) Perfection by filing permitted. — A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.

(b) Control or possession of certain collateral. — Except as otherwise provided in G.S. 25-9-315(c) and (d) for proceeds:

(1) A security interest in a deposit account may be perfected only by control under G.S. 25-9-314;

(2) And except as otherwise provided in G.S. 25-9-308(d), a security interest in a letter-of-credit right may be perfected only by control under G.S. 25-9-314; and

(3) A security interest in money may be perfected only by the secured party's taking possession under G.S. 25-9-313.

(c) Goods covered by negotiable document. — While goods are in the possession of a bailee that has issued a negotiable document covering the goods:

(1) A security interest in the goods may be perfected by perfecting a security interest in the document; and

(2) A security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.

(d) Goods covered by nonnegotiable document. — While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

(1) Issuance of a document in the name of the secured party;

(2) The bailee's receipt of notification of the secured party's interest; or

(3) Filing as to the goods.

(e) Temporary perfection: new value. — A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession or control for a period of 20 days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

(f) Temporary perfection: goods or documents made available to debtor. — A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for 20 days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

(1) Ultimate sale or exchange; or
(2) Loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

(g) Temporary perfection: delivery of security certificate or instrument to debtor. — A perfected security interest in a certificated security or instrument remains perfected for 20 days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:
(1) Ultimate sale or exchange; or
(2) Presentation, collection, enforcement, renewal, or registration of transfer.

(h) Expiration of temporary perfection. — After the 20-day period specified in subsection (e), (f), or (g) of this section expires, perfection depends upon compliance with this Article. (1997-181, s. 5; 2000-169, s. 1; 2006-112, s. 50.)

OFFICIAL COMMENT

1. **Source.** Former section 9-304, with additions and some changes.

2. **Instruments.** Under subsection (a), a security interest in instruments may be perfected by filing. This rule represents an important change from former article 9, under which the secured party's taking possession of an instrument was the only method of achieving long-term perfection. The rule is likely to be particularly useful in transactions involving a large number of notes that a debtor uses as collateral but continues to collect from the makers. A security interest perfected by filing is subject to defeat by certain subsequent purchasers (including secured parties). Under section 9-330(d), purchasers for value who take possession of an instrument without knowledge that the purchase violates the rights of the secured party generally would achieve priority over a security interest in the instrument perfected by filing. In addition, section 9-331 provides that filing a financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course and taking free of all claims under section 3-306.

3. **Chattel Paper; Negotiable Documents.** Subsection (a) further provides that filing is available as a method of perfection for security interests in chattel paper and negotiable documents. Tangible chattel paper is sometimes delivered to the assignee, and sometimes left in the hands of the assignor for collection. Subsection (a) allows the assignee to perfect its security interest by filing in the latter case. Alternatively, the assignee may perfect by taking possession. See section 9-313(a). An assignee of electronic chattel paper may perfect by taking control. See sections 9-105 and 9-314(a). The security interest of an assignee who takes possession or control may qualify for priority over a competing security interest perfected by filing. See section 9-330.

Negotiable documents may be, and usually are, delivered to the secured party. The secured party's taking possession will suffice as a perfection step. See section 9-313(a). However, as is the case with chattel paper, a security interest in a negotiable document may be perfected by filing.

4. **Investment Property.** A security interest in investment property, including certificated securities, uncertificated securities, security entitlements, and securities accounts, may be perfected by filing. However, security interests created by brokers, securities intermediaries, or commodity intermediaries are automatically perfected; filing is of no effect. See section 9-309(10) and (11). A security interest in all kinds of investment property also may be perfected by control, see sections 9-105 and 9-314, and a security interest in a certificated security also may be perfected by the secured party's taking delivery under section 8-301. See section 9-313(a). A security interest perfected only by filing is subordinate to a conflicting security interest perfected by control or delivery. See section 9-328(1) and (5). Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same collateral to another party who obtains control. Also, perfection by filing would not give the secured party protection against other types of adverse claims, since the article 8 adverse claim cut-off rules require control. See section 8-510.

5. **Deposit Accounts.** Under new subsection (b)(1), the only method of perfecting a security interest in a deposit account as original collateral is by control. Filing is ineffective, except as provided in section 9-315 with respect to proceeds. As explained in section 9-104, "control" can arise as a result of an agreement among the secured party, debtor, and bank, whereby the bank agrees to comply with instructions of the

secured party with respect to disposition of the funds on deposit, even though the debtor retains the right to direct disposition of the funds. Thus, subsection (b)(1) takes an intermediate position between certain non-UCC law, which conditions the effectiveness of a security interest on the secured party's enjoyment of such dominion and control over the deposit account that the debtor is unable to dispose of the funds, and the approach this article takes to securities accounts, under which a secured party who is unable to reach the collateral without resort to judicial process may perfect by filing. By conditioning perfection on "control," rather than requiring the secured party to enjoy absolute dominion to the exclusion of the debtor, subsection (b)(1) permits perfection in a wide variety of transactions, including those in which the secured party actually relies on the deposit account in extending credit and maintains some meaningful dominion over it, but does not wish to deprive the debtor of access to the funds altogether.

6. **Letter-of-Credit Rights.** Letter-of-credit rights commonly are "supporting obligations," as defined in section 9-102. Perfection as to the related account, chattel paper, document, general intangible, instrument, or investment property will perfect as to the letter-of-credit rights. See section 9-308(d). Subsection (b)(2) provides that, in other cases, a security interest in a letter-of-credit right may be perfected only by control. "Control," for these purposes, is explained in section 9-107.

7. **Goods Covered by Document of Title.** Subsection (c) applies to goods in the possession of a bailee who has issued a negotiable document covering the goods. Subsection (d) applies to goods in the possession of a bailee who has issued a nonnegotiable document of title, including a document of title that is "non-negotiable" under section 7-104. Section 9-313 governs perfection of a security interest in goods in the possession of a bailee who has not issued a document of title.

Subsection (c) clarifies the perfection and priority rules in former section 9-304(2). Consistently with the provisions of article 7, subsection (c) takes the position that, as long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document. Accordingly, a security interest in goods covered by a negotiable document may be perfected by perfecting a security interest in the document. The security interest also may be perfected by another method, e.g., by filing. The priority rule in subsection (c) governs only priority between (i) a security interest in goods which is perfected by perfecting in the document and (ii) a security interest in the goods which becomes perfected by another method while the goods are covered by the document.

Example 1: While wheat is in a grain elevator and covered by a negotiable warehouse receipt, Debtor creates a security interest in the wheat in favor of SP-1 and SP-2. SP-1 perfects by filing a financing statement covering "wheat." Thereafter, SP-2 perfects by filing a financing statement describing the warehouse receipt. Subsection (c)(1) provides that SP-2's security interest is perfected. Subsection (c)(2) provides that SP-2's security interest is senior to SP-1's.

Example 2: The facts are as in Example 1, but SP-1's security interest attached and was perfected before the goods were delivered to the grain elevator. Subsection (c)(2) does not apply, because SP-1's security interest did not become perfected during the time that the wheat was in the possession of a bailee. Rather, the first-to-file-or-perfect priority rule applies. See section 9-322.

A secured party may become "a holder to whom a negotiable document of title has been duly negotiated" under section 7-501. If so, the secured party acquires the rights specified by article 7. Article 9 does not limit those rights, which may include the right to priority over an earlier-perfected security interest. See section 9-331(a).

Subsection (d) takes a different approach to the problem of goods covered by a nonnegotiable document. Here, title to the goods is not looked on as being locked up in the document, and the secured party may perfect its security interest directly in the goods by filing as to them. The subsection provides two other methods of perfection: Issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a nonnegotiable warehouse receipt) and receipt of notification of the secured party's interest by the bailee. Perfection under subsection (d) occurs when the bailee receives notification of the secured party's interest in the goods, regardless of who sends the notification. Receipt of notification is effective to perfect, regardless of whether the bailee responds. Unlike former section 9-304(3), from which it derives, subsection (d) does not apply to goods in the possession of a bailee who has not issued a document of title. Section 9-313(c) covers that case and provides that perfection by possession as to goods not covered by a document requires the bailee's acknowledgment.

8. **Temporary Perfection Without Having First Otherwise Perfected.** Subsection (e) follows former section 9-304(4) in giving perfected status to security interests in certificated securities, instruments, and negotiable documents for a short period (reduced from 21 to 20 days, which is the time period generally applicable in this article), although there has been no filing and the collateral is in the

debtor's possession. The 20-day temporary perfection runs from the date of attachment. There is no limitation on the purpose for which the debtor is in possession, but the secured party must have given "new value" (defined in section 9-102) under an authenticated security agreement.

9. **Maintaining Perfection After Surrendering Possession.** There are a variety of legitimate reasons—many of them are described in subsections (f) and (g)—why certain types of collateral must be released temporarily to a debtor. No useful purpose would be served by cluttering the files with records of such exceedingly short term transactions.

Subsection (f) affords the possibility of 20-day perfection in negotiable documents and goods in the possession of a bailee but not covered by a negotiable document. Subsection (g) provides for 20-day perfection in certificated securities and instruments. These subsections derive from former section 9-305(5). However, the period of temporary perfection has been reduced from 21 to 20 days, which is the time period generally applicable in this article, and "enforcement" has been added in subsection (g) as one of the special and limited purposes for which a secured party can release an instrument or certificated security to the debtor and still remain perfected. The period of temporary perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor. There is no new value requirement, but the turnover must be for one or more of the purposes stated in subsection (f) or (g). The 20-day period may be extended by perfecting as to the collateral by another method before the period expires. However, if the security interest is not perfected by another method until after the 20-day period expires, there will be a gap during which the security interest is unperfected.

Temporary perfection extends only to the negotiable document or goods under subsection (f) and only to the certificated security or instrument under subsection (g). It does not extend to proceeds. If the collateral is sold, the security interest will continue in the proceeds for the period specified in section 9-315.

Subsections (f) and (g) deal only with perfection. Other sections of this article govern the priority of a security interest in goods after surrender of the document covering them. In the case of a purchase-money security interest in inventory, priority may be conditioned upon giving notification to a prior inventory financer. See section 9-324.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 50, effective October 1, 2006, inserted "or control" in subsection (e).

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Creditor Remains Perfected Where Substance of Debt Does Not Change. — Where creditor had a perfected security interest in debtor's accounts receivable, debtor exchanged the accounts receivable owed to it for promissory notes, and the transaction which transformed the accounts receivable into notes was done by related, if not identical, parties and was never disclosed to creditor, the substance of the debt had not changed and creditor remained perfected in the accounts receivable, even though they presently existed in the form of promissory notes and the creditor did not have possession of those notes as required. In re Guil-Park Farms, Inc., 90 Bankr. 180 (Bankr. W.D.N.C. 1988).

Cited in Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-313. When possession by or delivery to secured party perfects security interest without filing.

(a) Perfection by possession or delivery. — Except as otherwise provided in subsection (b) of this section, a secured party may perfect a security interest in tangible negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under G.S. 25-8-301.

(b) Goods covered by certificate of title. — With respect to goods covered by a certificate of title issued by this State, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in G.S. 25-9-316(d).

(c) Collateral in possession of person other than debtor. — With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:

(1) The person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit; or

(2) The person takes possession of the collateral after having authenticated a record acknowledging that it will hold possession of collateral for the secured party's benefit.

(d) Time of perfection by possession; continuation of perfection. — If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.

(e) Time of perfection by delivery; continuation of perfection. — A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under G.S. 25-8-301 and remains perfected by delivery until the debtor obtains possession of the security certificate.

(f) Acknowledgment not required. — A person in possession of collateral is not required to acknowledge that it holds possession for a secured party's benefit.

(g) Effectiveness of acknowledgment; no duties or confirmation. — If a person acknowledges that it holds possession for the secured party's benefit:

(1) The acknowledgment is effective under subsection (c) of this section or G.S. 25-8-301(a), even if the acknowledgment violates the rights of a debtor; and

(2) Unless the person otherwise agrees or law other than this Article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

(h) Secured party's delivery to person other than debtor. — A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(1) To hold possession of the collateral for the secured party's benefit; or

(2) To redeliver the collateral to the secured party.

(i) Effect of delivery under subsection (h); no duties or confirmation. — A secured party does not relinquish possession, even if a delivery under subsection (h) of this section violates the rights of a debtor. A person to which collateral is delivered under subsection (h) of this section does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this Article otherwise provides. (1997-181, s. 5; 2000-169, s. 1; 2006-112, s. 51.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former sections 9-115(6) and 9-305.

2. **Perfection by Possession.** As under the common law of pledge, no filing is required by this article to perfect a security interest if the secured party takes possession of the collateral. See section 9-310(b)(6).

This section permits a security interest to be perfected by the taking of possession only when the collateral is goods, instruments, negotiable documents, money, or tangible chattel paper. Accounts, commercial tort claims, deposit accounts, investment property, letter-of-credit rights, letters of credit, and oil, gas, or other minerals before extraction are excluded. (But see comment 6, below, regarding certificated securities.) A security interest in accounts and payment intangibles—property not ordinarily represented by any writing whose delivery operates to transfer the right to payment—may under this article be perfected only by filing. This rule would not be affected by the fact that a security agreement or other record described the assignment of such collateral as a "pledge." Section 9-309(2) exempts from filing certain assignments of accounts or payment intangibles which are out of the ordinary course of financing. These exempted assignments are perfected when they attach. Similarly, under section 9-309(3), sales of payment intangibles are automatically perfected.

3. **"Possession."** This section does not define "possession." It adopts the general concept as it developed under former Article 9. As under former Article 9, in determining whether a particular person has possession, the principles of agency apply. For example, if the collateral is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession, and subsection (c) does not apply. Sometimes a person holds collateral both as an agent of the secured party and as an agent of the debtor. The fact of dual agency is not of itself inconsistent with the secured party's having taken possession (and thereby having rendered subsection (c) inapplicable). The debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession. And, under appropriate circumstances, a court may determine that a person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even though the person may have agreed to take possession on behalf of the secured party. If so, the person's taking possession would not constitute the secured party's taking possession and would not be sufficient for perfection. See also Section 9-205(b). In a typical escrow arrangement, where the escrowee has possession of collateral as agent for both the secured party and the debtor, the debtor's relationship to the escrowee is not such as to constitute retention of possession by the debtor.

4. **Goods in Possession of Third Party: Perfection.** Former section 9-305 permitted perfection of a security interest by notification to a bailee in possession of collateral. This article distinguishes between goods in the possession of a bailee who has issued a document of title covering the goods and goods in the possession of a third party who has not issued a document. Section 9-312(c) or (d) applies to the former, depending on whether the document is negotiable. Section 9-313(c) applies to the latter. It provides a method of perfection by possession when the collateral is possessed by a third person who is not the secured party's agent.

Notification of a third person does not suffice to perfect under section 9-313(c). Rather, perfection does not occur unless the third person authenticates an acknowledgment that it holds possession of the collateral for the secured party's benefit. Compare section 9-312(d), under which receipt of notification of the security party's interest by a bailee holding goods covered by a nonnegotiable document is sufficient to perfect, even if the bailee does not acknowledge receipt of the notification. A third person may acknowledge that it will hold for the secured party's benefit goods to be received in the future. Under these circumstances, perfection by possession occurs when the third person obtains possession of the goods.

Under subsection (c), acknowledgment of notification by a "lessee ... in ... ordinary course of ... business" (defined in section 2A-103) does not suffice for possession. The section thus rejects the reasoning of In re Atlantic Systems, Inc., 135 B.R. 463 (Bankr. S.D.N.Y. 1992) (holding that notification to debtor-lessor's lessee sufficed to perfect security interest in leased goods). See Steven O. Weise, Perfection by Possession: The Need for an Objective Test, 29 Idaho Law Rev. 705 (1992-93) (arguing that lessee's possession in ordinary course of debtor-lessor's business does not provide adequate public notice of possible security interest in leased goods). Inclusion of a per se rule concerning lessees is not meant to preclude a court, under appropriate circumstances, from determining that a third person is so closely connected to or controlled by the debtor that the debtor has retained effective possession. If so, the third person's acknowledgment would not be sufficient for perfection.

In some cases, it may be uncertain whether a person who has possession of collateral is an agent of the secured party or a non-agent bailee. Under those circumstances, prudence might suggest that the secured party obtain the person's acknowledgment to avoid litigation and ensure perfection by possession regardless of how the relationship between the secured part and the person is characterized.

5. **No Relation Back.** Former section 9-305 provided that a security interest is perfected by possession from the time possession is taken "without a relation back." As the comment to former section 9-305 observed, the relation-back theory, under which the taking of possession was deemed to relate back to the date of the original security agreement, has had little vitality since the 1938 revision of the Federal Bankruptcy Act. The theory is inconsistent with former article 9 and with this article. See section 9-313(d). Accordingly, this article deletes the quoted phrase as unnecessary. Where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected. The only exceptions to this rule are the short, 20-day periods of perfection provided in section 9-312(e), (f), and (g), during which a debtor may have possession of specified collateral in which there is a perfected security interest.

6. **Certificated Securities.** The second sentence of subsection (a) reflects the traditional rule for perfection of a security interest in certificated securities. Compare sections 8-313(1)(a) and 8-321 (1978 Official Text); section 9-115(6) (1994 Official Text); and section 9-305 (1972 Official Text). It has been modified to refer to "delivery" under section 8-301. Corresponding changes appear in section 9-203(b).

Subsection (e), which is new, applies to a secured party in possession of security certificates another person who has taken delivery of security certificates and holds them for the secured party's benefit under section 8-301. See Comment 8.

Under subsection (e), a possessory security interest in a certificated security remains perfected until the debtor obtains possession of the security certificate. This rule is analogous to that of section 9-314(c), which deals with perfection of security interests in investment property by control. See section 9-314, comment 3.

7. **Goods Covered by Certificate of Title.** Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in the comments to section 9-311. Subsection (b), like subsection (a), does not create a right to take possession. Rather, it indicates the circumstances under which the secured party's taking possession of goods covered by a certificate of title is effective to perfect a security interest in the goods: The goods become covered by a certificate of title issued by this state at a time when the security interest is perfected by any method under the law of another jurisdiction.

8. **Goods in Possession of Third Party: No Duty to Acknowledge; Consequences of Acknowledgment.** Subsections (f) and (g) are new and address matters as to which former article 9 was silent. They derive in part from section 8-106(g). Subsection (f) provides that a person in possession of collateral is not required to acknowledge that it holds for a secured party. Subsection (g)(1) provides that an acknowledgment is effective even if wrongful as to the debtor. Subsection (g)(2) makes clear that an acknowledgment does not give rise to any duties or responsibilities under this article. Arrangements involving the possession of goods are hardly standardized. They include bailments for services to be performed on the goods (such as repair or processing), for use (leases), as security (pledges), for carriage, and for storage. This article leaves to the agreement of the parties and to any other applicable law the imposition of duties and responsibilities upon a person who acknowledges under subsection (c). For example, by acknowledging, a third party does not become obliged to act on the secured party's direction or to remain in possession of the collateral unless it agrees to do so or other law so provides.

9. **Delivery to Third Party by Secured Party.** New subsections (h) and (i) address the practice of mortgage warehouse lenders. These lenders typically send mortgage notes to prospective purchasers under cover of letters advising the prospective purchasers that the lenders hold security interests in the notes. These lenders relied on notification to maintain perfection under former section 9-305. Requiring them to obtain authenticated acknowledgments from each prospective purchaser under subsection (c) could be unduly burdensome and

disruptive of established practices. Under subsection (h), when a secured party in possession itself delivers the collateral to a third party, instructions to the third party would be sufficient to maintain perfection by possession; an acknowledgment would not be necessary. Under subsection (i), the secured party does not relinquish possession by making a delivery under subsection (h), even if the delivery violates the rights of the debtor. That subsection also makes clear that a person to whom collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this article provides otherwise.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 51, effective October 1, 2006, inserted "tangible" preceding "negotiable documents" in the first sentence of subsection (a).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Where defendant had a perfected security interest in a note due to possession of that note when the maker thereof used the note as collateral to secure a loan from plaintiff, plaintiff's security agreement was subject to defendant's security interest. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Interruption of Possession. — Where no exception was made to trial court's ruling that sheriff's levy (for plaintiff) interrupted defendant's possession of collateral, and defendant claimed perfected security interest in the property by possession, that ruling became law of the case; therefore, since defendant's lien perfection was based only on possession of the collateral and sheriff's levy interrupted that possession in this case, court erred in finding defendant had priority over plaintiff, despite dicta by Court of Appeal indicating prior perfected security interest by possession would have priority over subsequent sheriff's levy of same property. Waterhouse v. Carolina Limousine Mfg., Inc., 96 N.C. App. 109, 384 S.E.2d 293, cert. denied, 326 N.C. 54, 389 S.E.2d 107 (1990).

§ 25-9-314. Perfection by control.

(a) Perfection by control. — A security interest in investment property, deposit accounts, letter-of-credit rights, electronic chattel paper, or electronic documents may be perfected by control of the collateral under G.S. 25-7-106, 25-9-104, 25-9-105, 25-9-106, or 25-9-107.

(b) Specified collateral: time of perfection by control; continuation of perfection. — A security interest in deposit accounts, electronic chattel paper, letter-of-credit rights, or electronic documents is perfected by control under G.S. 25-7-106, 25-9-104, 25-9-105, or 25-9-107 when the secured party obtains control and remains perfected by control only while the secured party retains control.

(c) Investment property: time of perfection by control; continuation of perfection. — A security interest in investment property is perfected by control under G.S. 25-9-106 from the time the secured party obtains control and remains perfected by control until:

(1) The secured party does not have control; and

(2) One of the following occurs:

a. If the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

b. If the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner; or

c. If the collateral is a security entitlement, the debtor is or becomes the entitlement holder. (1997-181, s. 5; 2000-169, s. 1; 2006-112, s. 52.)

OFFICIAL COMMENT

1. **Source.** Substantially new; derived in part from former section 9-115(4).

2. **Control.** This section provides for perfection by control with respect to investment property, deposit accounts, letter-of-credit rights, and electronic chattel paper. For explanations of how a secured party takes control of these types of collateral, see sections 9-104 through 9-107. Subsection (b) explains when a security interest is perfected by control and how long a security interest remains perfected by control. Like section 9-313(d) and for the same reasons, subsection (b) makes no reference to the doctrine of "relation back." See section 9-313, comment 5.

3. **Investment Property.** Subsection (c) provides a special rule for investment property. Once a secured party has control, its security interest remains perfected by control until the secured party ceases to have control and the debtor receives possession of collateral that is a certificated security, becomes the registered owner of collateral that is an uncertificated security, or becomes the entitlement holder of collateral that is a security entitlement. The result is particularly important in the "repledge" context. See section 9-207, comment 5.

In a transaction in which a secured party who has control grants a security interest in investment property or sells outright the investment property, by virtue of the debtor's consent or applicable legal rules, a purchaser from the secured party typically will cut off the debtor's rights in the investment property or be immune from the debtor's claims. See section 9-207, comments 5 and 6. If the investment property is a security, the debtor normally would retain no interest in the security following the purchase from the secured party, and a claim of the debtor against the secured party for redemption (section 9-623) or otherwise with respect to the security would be a purely personal claim. If the investment property transferred by the secured party is a financial asset in which the debtor had a security entitlement credited to a securities account maintained with the secured party as a securities intermediary, the debtor's claim against the secured party could arise as a part of its securities account notwithstanding its personal nature. (This claim would be analogous to a "credit balance" in the securities account, which is a component of the securities account even though it is a personal claim against the intermediary.) In the case in which the debtor may retain an interest in investment property notwithstanding a repledge or sale by the secured party, subsection (c) makes clear that the security interest will remain perfected by control.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 52, effective October 1, 2006, in subsection (a), deleted "or" preceding "electronic chattel paper", and inserted "or electronic documents" and "25-7-106"; and in subsection (b), deleted "or" preceding "letter-of-credit," and inserted "or electronic documents" and "25-7-106."

§ 25-9-315. Secured party's rights on disposition of collateral and in proceeds.

(a) Disposition of collateral: continuation of security interest or agricultural lien; proceeds. — Except as otherwise provided in this Article and in G.S. 25-2-403(2):

(1) A security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(2) A security interest attaches to any identifiable proceeds of collateral.

(b) When commingled proceeds identifiable. — Proceeds that are commingled with other property are identifiable proceeds:

(1) If the proceeds are goods, to the extent provided by G.S. 25-9-336; and

(2) If the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this Article with respect to commingled property of the type involved.

(c) Perfection of security interest in proceeds. — A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) Continuation of perfection. — A perfected security interest in proceeds becomes unperfected on the twenty-first day after the security interest attaches to the proceeds unless:

(1) The following conditions are satisfied:

a. A filed financing statement covers the original collateral;

b. The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

c. The proceeds are not acquired with cash proceeds;

(2) The proceeds are identifiable cash proceeds; or

(3) The security interest in the proceeds is perfected other than under subsection (c) of this section when the security interest attaches to the proceeds or within 20 days thereafter.

(e) When perfected security interest in proceeds becomes unperfected. — If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subdivision (d)(1) of this section becomes unperfected at the later of:

(1) When the effectiveness of the filed financing statement lapses under G.S. 25-9-515 or is terminated under G.S. 25-9-513; or

(2) The twenty-first day after the security interest attaches to the proceeds. (1945, c. 196, s. 8; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1997-181, ss. 12, 13; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-306.

2. **Continuation of Security Interest or Agricultural Lien Following Disposition of Collateral.** Subsection (a)(1)(A), which derives from former section 9-306(2), contains the general rule that a security interest survives disposition of the collateral. In these cases, the secured party may repossess the collateral from the transferee or, in an appropriate case, maintain an action for conversion. The secured party may claim both any proceeds and the original collateral but, of course, may have only one satisfaction.

In many cases, a purchaser or other transferee of collateral will take free of a security interest, and the secured party's only right will be to proceeds. For example, the general rule does not apply, and a security interest does not continue in collateral, if the secured party authorized the disposition, in the agreement that contains the security agreement or otherwise. Subsection (a)(1)(A) adopts the view of PEB Commentary No. 3 and makes explicit that the authorized disposition to which it refers is an authorized disposition "free of" the security interest or agricultural lien. The secured party's right to proceeds under this section or under the express terms of an agreement does not in itself constitute an authorization of disposition. The change in language from former section 9-306(2) is not intended to address the frequently litigated situation in which the effectiveness of the secured party's consent to a disposition is conditioned upon the secured party's receipt of the proceeds. In that situation, subsection (a) leaves the determination of authorization to the courts, as under former article 9.

This article contains several provisions under which a transferee takes free of a security interest or agricultural lien. For example, section 9-317 states when transferees take free of unperfected security interests; sections 9-320 and 9-321 on goods, 9-321 on general intangibles, 9-330 on chattel paper and instruments, and 9-331 on negotiable instruments, negotiable documents, and securities state when purchasers of such collateral take free of a security interest, even though perfected and even though the disposition was not authorized. Section 9-332 enables most transferees (including nonpurchasers) of funds from a deposit account and most transferees of money to take free of a perfected security interest in the deposit account or money.

Likewise, the general rule that a security interest survives disposition does not apply if the secured party entrusts goods collateral to a merchant who deals in goods of that kind and the merchant sells the collateral to a buyer in ordinary course of business. Section 2-403(2) gives the merchant the power to transfer all the secured party's rights to the buyer, even if the sale is wrongful as against the secured party. Thus, under subsection (a)(1)(A), an entrusting secured party runs the same risk as any other entruster.

3. **Secured Party's Right to Identifiable Proceeds.** Under subsection (a)(1)(B), which derives from former section 9-306(2), a security interest attaches to any identifiable "proceeds," as defined in section 9-102. See also section 9-203(f). Subsection (b) is new. It indicates when proceeds commingled with other property are identifiable proceeds and permits the use of whatever methods of tracing other law permits with respect to the type of property involved. Among the "equitable principles" whose use other law may permit is the "lowest intermediate balance rule." See Restatement (2d), Trusts section 202.

4. **Automatic Perfection in Proceeds: General Rule.** Under subsection (c), a security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected. This article extends the period of automatic perfection in proceeds from 10 days to 20 days. Generally, a security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds. See subsection (d). The loss of perfected status under subsection (d) is prospective only. Compare, e.g., section 9-515(c) (deeming security interest unperfected retroactively).

5. **Automatic Perfection in Proceeds: Proceeds Acquired with Cash Proceeds.** Subsection (d)(1) derives from former section 9-306(3)(a). It carries forward the basic rule that a security interest in proceeds remains perfected beyond the period of automatic perfection if a filed financing statement covers the original collateral (e.g., inventory) and the proceeds are collateral in which a security interest may be perfected by filing in the office where the financing statement has been filed (e.g., equipment). A different rule applies if the proceeds are acquired with cash proceeds, as is the case if the original collateral (inventory) is sold for cash (cash proceeds) that is used to purchase equipment (proceeds). Under these circumstances, the security interest in the equipment proceeds remains perfected only if the description in the filed financing indicates the type of property constituting the proceeds (e.g., "equipment").

This section reaches the same result but takes a different approach. It recognizes that the treatment of proceeds acquired with cash proceeds under former section 9-306(3)(a) essentially was superfluous. In the example, had the filing covered "equipment" as well as "inventory," the security interest in the proceeds would have been perfected under the usual rules governing after-acquired equipment (see former sections 9-302 and 9-303); paragraph (3)(a) added only an exception to the general rule. Subsection (d)(1)(C) of this section takes a more direct approach. It makes the general rule of continued perfection inapplicable to proceeds acquired with cash proceeds, leaving perfection of a security interest in those proceeds to the generally applicable perfection rules under subsection (d)(3).

Example 1: Lender perfects a security interest in Debtor's inventory by filing a financing statement covering "inventory." Debtor sells the inventory and deposits the buyer's check into a deposit account. Debtor draws a check on the deposit account and uses it to pay for equipment. Under the "lowest intermediate balance rule," which is a permitted method of tracing in the relevant jurisdiction, see comment 3, the funds used to pay for the equipment were identifiable proceeds of the inventory. Because the proceeds (equipment) were acquired with cash proceeds (deposit account), subsection (d)(1) does not extend perfection beyond the 20-day automatic period.

Example 2: Lender perfects a security interest in Debtor's inventory by filing a financing statement covering "all debtor's property." As in Example 1, Debtor sells the inventory, deposits the buyer's check into a deposit account, draws a check on the deposit account, and uses the check to pay for equipment. Under the "lowest intermediate balance rule," which is a permitted method of tracing in the relevant jurisdiction, see comment 3, the funds used to pay for the equipment were identifiable proceeds of the inventory. Because the proceeds (equipment) were acquired with cash proceeds (deposit account), subsection (d)(1) does not extend perfection beyond the 20-day automatic period. However, because the financing statement is sufficient to perfect a security interest in debtor's equipment, under subsection (d)(3) the security interest in the equipment proceeds remains perfected beyond the 20-day period.

6. **Automatic Perfection in Proceeds: Lapse or Termination of Financing Statement During 20-Day Period; Perfection Under Other Statute or Treaty.** Subsection (e) provides that a security interest in proceeds perfected under subsection (d)(1) ceases to be perfected when the financing statement covering the original collateral lapses or is terminated. If the lapse or termination occurs before the 21st day after the security interest attaches, however, the security interest in the proceeds remains perfected until the 21st day. Section 9-311(b) provides that compliance with the perfection requirements of a statute or treaty described in section 9-311(a) "is equivalent to the filing of a financing statement." It follows that collateral subject to a security interest perfected by such compliance under section 9-311(b) is covered by a "filed financing statement" within the meaning of section 9-315(d) and (e).

7. **Automatic Perfection in Proceeds: Continuation of Perfection in Cash Proceeds.** Former section 9-306(3)(b) provided that if a filed financing statement covered original collateral, a security interest in identifiable cash proceeds of the collateral remained perfected beyond the ten-day period of automatic perfection. Former section 9-306(3)(c) contained a similar rule with respect to identifiable cash proceeds of investment property. Subsection (d)(2) extends the benefits of former sections 9-306(3)(b) and (3)(c) to identifiable cash proceeds of all types of original collateral in which a security interest is perfected by any method. Under subsection (d)(2), if the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected. In many cases, however, a purchaser or other transferee of the cash proceeds will take free of the perfected security interest. See, e.g., sections 9-330(d) (purchaser of check), 9-331 (holder in due course of check), and 9-332 (transferee of money or funds from a deposit account).

8. **Insolvency Proceedings; Returned and Repossessed Goods.** This article deletes former section 9-306(4), which dealt with proceeds in insolvency proceedings. Except as otherwise provided by the Bankruptcy Code, the debtor's entering into bankruptcy does not affect a secured party's right to proceeds.

This article also deletes former section 9-306(5), which dealt with returned and repossessed goods. Section 9-330, comments 9 to 11, explain and clarify the application of priority rules to returned and repossessed goods as proceeds of chattel paper.

9. **Proceeds of Collateral Subject to Agricultural Lien.** This article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an "agricultural lien" (defined in section 9-102) arises under other law, then the agricultural-lien provisions of this article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.

Legal Periodicals. — For comment, "Entrustment under U.C.C. Section 2-403 and Its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Continuously Perfected Security Interest. — If the security interest in the original collateral is perfected and the filed financing statement covering the original collateral also covers proceeds, the security interest in the proceeds is a "continuously perfected security interest." Michigan Nat'l Bank v. Flowers Mobile Homes Sales, 26 N.C. App. 690, 217 S.E.2d 108 (1975).

"Proceeds." — Although peanut company gave value to debtors at the time of its receipt of matured peanuts which the debtors had agreed to convey in exchange for peanut seed which had been furnished to them by the company, such value was not "proceeds" to which bank's security could attach. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

Buyer Can Not Designate Prior Value Given to Debtor as "Proceeds." — To allow a buyer to designate prior value given to the debtor as "proceeds" of a subsequent sale of collateral authorized by a secured party would seriously undermine the latter's interest, resulting in commercial uncertainty contrary to the objective of the UCC. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

There is no express limitation on the right of a secured party to trace proceeds subject to his security interest into a bank account of the debtor. Michigan Nat'l Bank v. Flowers Mobile Homes Sales, 26 N.C. App. 690, 217 S.E.2d 108 (1975).

The mere fact that plaintiff had a security interest was insufficient to give rise to a claim against defendant under Article 9 or otherwise. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Right to Insurance Proceeds. — Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds, including insurance proceeds. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Article 9 clearly gives the secured party a security interest in insurance proceeds which is enforceable against the debtor upon default. In other words, the secured party's interest in damaged or destroyed collateral continues in the insurance proceeds payable because of that damage or loss. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Having an enforceable security interest does not necessarily mean that a secured party has a claim against the insurer for those proceeds. The creditor's security interest in proceeds is enforceable against the debtor as soon as the proceeds are in the debtor's hands and, if continuously perfected, that interest is superior to the claims of intervening creditors from the moment insurance is payable. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Where no action was ever demanded of defendant debtor to obtain insurance on his crops on behalf of plaintiff, the secured party, and where the debtor took out insurance on the crops at the insistence of, and for the benefit of, the United States Farmers Home Administration (FmHA), plaintiff had no claim against the insurer and was not justified in interfering with the insurer's payment of the proceeds; moreover, to the extent that the insurance proceeds may have exceeded the debt owed to FmHA, plaintiff was still not entitled to make a demand for payment of those proceeds until they fell into the hands of defendant debtor. Lyon v. May, 108 N.C. App. 633, 424 S.E.2d 655, cert. denied, 333 N.C. 791, 431 S.E.2d 25 (1993).

Bank's Right to Damage Proceeds on Collateral. — Bank had the right to require defendant to turn over to the bank for application on a note the proceeds of a check issued for damages to collateral machinery, rather than allowing defendants to use the proceeds to repair the machinery. Northside Properties, Inc. v. Ko-Ko Mart, Inc., 28 N.C. App. 532, 222 S.E.2d 267, cert. denied, 289 N.C. 615, 223 S.E.2d 392 (1976).

Creditor Remains Perfected Where Substance of Debt Does Not Change. — Where creditor had a perfected security interest in debtor's accounts receivable, debtor exchanged the accounts receivable owed to it for promissory notes, and the transaction which transformed the accounts receivable into notes was done by related, if not identical, parties and was never disclosed to creditor, the substance of the debt had not changed and creditor remained perfected in the accounts receivable, even though they presently existed in the form of promissory notes and the creditor did not have possession of those notes as required by former G.S. 25-9-304. In re Guil-Park Farms, Inc., 90 Bankr. 180 (Bankr. W.D.N.C. 1988).

Language of Agreement Indicated Consent. — Appliance manufacturer's security interest in appliances sold to developer of apartments, which apartments were sold by developer to limited partnership after appliances were installed, was terminated as a result of the sale of the appliances to the limited partnership, because the language in the security agreement between the developer and the appliance manufacturer made it clear that the appliance manufacturer, if not expressly then at least impliedly, consented to the resale. The court was troubled, however, by the fact that the same party served as president of the developer and as the only noncorporate general partner of the limited partnership. Whirlpool Corp. v. Dailey Constr., Inc., 110 N.C. App. 468, 429 S.E.2d 748 (1993).

§ 25-9-316. Continued perfection of security interest following change in governing law.

(a) General rule: effect on perfection of change in governing law. — A security interest perfected pursuant to the law of the jurisdiction designated in G.S. 25-9-301(1) or G.S. 25-9-305(c) remains perfected until the earliest of:

(1) The time perfection would have ceased under the law of that jurisdiction;
(2) The expiration of four months after a change of the debtor's location to another jurisdiction; or
(3) The expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

(b) Security interest perfected or unperfected under law of new jurisdiction. — If a security interest described in subsection (a) of this section becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(c) Possessory security interest in collateral moved to new jurisdiction. — A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:

(1) The collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;
(2) Thereafter the collateral is brought into another jurisdiction; and
(3) Upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.

(d) Goods covered by certificate of title from this State. — Except as otherwise provided in subsection (e) of this section, a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this State remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.

(e) When subsection (d) security interest becomes unperfected against purchasers. — A security interest described in subsection (d) of this section becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under G.S. 25-9-311(b) or G.S. 25-9-313 are not satisfied before the earlier of:

(1) The time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become covered by a certificate of title from this State; or
(2) The expiration of four months after the goods had become so covered.

(f) Change in jurisdiction of bank, issuer, nominated person, securities intermediary, or commodity intermediary. — A security interest in deposit accounts, letter-of-credit rights, or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

(1) The time the security interest would have become unperfected under the law of that jurisdiction; or
(2) The expiration of four months after a change of the applicable jurisdiction to another jurisdiction.

(g) Subsection (f) security interest perfected or unperfected under law of new jurisdiction. — If a security interest described in subsection (f) of this section becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-103(1)(d), (2)(b), (3)(e), as modified.

2. **Continued Perfection.** This section deals with continued perfection of security interests that have been perfected under the law of another jurisdiction. The fact that the law of a particular jurisdiction ceases to govern perfection under sections 9-301 through 9-307 does not necessarily mean that a security interest perfected under that law automatically becomes unperfected. To the contrary: This section generally provides that a security interest perfected under the law of one jurisdiction remains perfected for a fixed period of time (four months or one year, depending on the circumstances), even though the jurisdiction whose law governs perfection changes. However, cessation of perfection under the law of the original jurisdiction cuts short the fixed period. The four-month and one-year periods are long enough for a secured party to discover in most cases that the law of a different jurisdiction governs perfection and to reperfect (typically by filing) under the law of that jurisdiction. If a secured party properly reperfects a security interest before it becomes unperfected under subsection (a), then the security interest remains perfected continuously thereafter. See subsection (b).

Example 1: Debtor is a general partnership whose chief executive office is in Pennsylvania. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania on May 15, 2002. On April 1, 2005, without Lender's knowledge, Debtor moves its chief executive office to New Jersey. Lender's security interest remains perfected for four months after the move. See subsection (a)(2).

Example 2: Debtor is a general partnership whose chief executive office is in Pennsylvania. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania on May 15, 2002. On April 1, 2007, without Lender's knowledge, Debtor moves its chief executive office to New Jersey. Lender's security interest remains perfected only through May 14, 2007, when the effectiveness of the filed financing statement lapses. See subsection (a)(1). Although, under these facts, Lender would have only a short period of time to discover that Debtor had relocated and to reperfect under New Jersey law, Lender could have protected itself by filing a continuation statement in Pennsylvania before Debtor relocated. By doing so, Lender would have prevented lapse and allowed itself the full four months to discover Debtor's new location and refile there or, if Debtor is in default, to perfect by taking possession of the equipment.

Example 3: Under the facts of Example 2, Lender files a financing statement in New Jersey before the effectiveness of the Pennsylvania financing statement lapses. Under subsection (b), Lender's security interest is continuously perfected beyond May 14, 2007, for a period determined by New Jersey's article 9.

Subsection (a)(3) allows a one-year period in which to reperfect. The longer period is necessary, because, even with the exercise of due diligence, the secured party may be unable to discover that the collateral has been transferred to a person located in another jurisdiction.

Example 4: Debtor is a Pennsylvania corporation. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania. Debtor's shareholders decide to "reincorporate" in Delaware. They form a Delaware corporation (Newcorp) into which they merge Debtor. The merger effectuates a transfer of the collateral from Debtor to Newcorp, which thereby becomes a debtor and is located in another jurisdiction. Under subsection (a)(3), the security interest remains perfected for one year after the merger. If a financing statement is filed in Delaware against Newcorp within the year following the merger, then the security interest remains perfected thereafter for a period determined by Delaware's article 9.

Note that although Newcorp is a "new debtor" as defined in section 9-102, the application of subsection (a)(3) is not limited to transferees who are new debtors. Note also that, under section 9-507, the financing statement naming Debtor remains effective even though Newcorp has become the debtor.

This section addresses security interests that are perfected (i.e., that have attached and as to which any required perfection step has been taken) before the debtor changes its location. As the following example explains, this section does not apply to security interests that have not attached before the location changes.

Example 5: Debtor is a Pennsylvania corporation. Debtor grants to Lender a security interest in Debtor's existing and after-acquired inventory. Lender perfects by filing in Pennsylvania. Debtor's shareholders decide to "reincorporate" in Delaware. They form a Delaware corporation (Newcorp) into which they merge Debtor. By virtue of the merger, Newcorp becomes bound by Debtor's security agreement. See section 9-203. After the merger, Newcorp acquires inventory to which Lender's security interest attaches. Because Newcorp is located in Delaware, Delaware law governs perfection of a security interest in Newcorp's inventory. See sections 9-301 and 9-307. Having failed to perfect under Delaware law, Lender holds an unperfected security interest in the inventory acquired by Newcorp after the merger. The same result follows regardless of the name of the Delaware corporation (i.e., even if the Delaware corporation and Debtor have the same name). A different result would occur if Debtor and Newcorp were incorporated in the same state. See Section 9-508. Comment 4.

3. **Retroactive Unperfection.** Subsection (b) sets forth the consequences of the failure to reperfect before perfection ceases under subsection (a): The security interest becomes unperfected prospectively and, as against purchasers for value, including buyers and secured parties, but not as against donees or lien creditors, retroactively. The rule applies to agricultural liens, as well. See also section 9-515 (taking the same approach with respect to lapse). Although this approach creates the potential for circular priorities, the alternative—retroactive unperfection against lien creditors—would create substantial and unjustifiable preference risks.

Example 6: Under the facts of Example 4, six months after the merger, Buyer bought from Newcorp some equipment formerly owned by Debtor. At the time of the purchase, Buyer took subject to Lender's perfected security interest, of which Buyer was unaware. See section 9-315(a)(1)(A). However, subsection (b) provides that if Lender fails to reperfect in Delaware within a year after the merger, its security interest becomes unperfected and is deemed never to have been perfected against Buyer. Having given value and received delivery of the equipment without knowledge of the security interest and before it was perfected, Buyer would take free of the security interest. See section 9-317(b).

Example 7: Under the facts of Example 4, one month before the merger, Debtor created a security interest in certain equipment in favor of Financer, who perfected by filing in Pennsylvania. At that time, Financer's security interest is subordinate to Lender's. See section 9-322(a)(1). Financer reperfects by filing in Delaware within a year after the merger, but Lender fails to do so. Under subsection (b), Lender's security interest is deemed never to have been perfected against Financer, a purchaser for value. Consequently, under section 9-322(a)(2), Financer's security interest is now senior.

Of course, the expiration of the time period specified in subsection (a) does not of itself prevent the secured party from later reperfecting under the law of the new jurisdiction. If the secured party does so, however, there will be a gap in perfection, and the secured party may lose priority as a result. Thus, in Example 7, if Lender perfects by filing in Delaware more than one year under the merger, it will have a new date of filing and perfection for purposes of section 9-322(a)(1). Financer's security interest, whose perfection dates back to the filing in Pennsylvania under subsection (b), will remain senior.

4. **Possessory Security Interests.** Subsection (c) deals with continued perfection of possessory security interests. It applies not only to security interests perfected solely by the secured party's having taken possession of the collateral. It also applies to security interests perfected by a method that includes as an element of perfection the secured party's having taken possession, such as perfection by taking delivery of a certificated security in registered form, see section 9-313(a), and perfection by obtaining control over a certificated security. See section 9-314(a).

5. **Goods Covered by Certificate of Title.** Subsections (d) and (e) address continued perfection of a security interest in goods covered by a certificate of title. The following examples explain the operation of those subsections.

Example 8: Debtor's automobile is covered by a certificate of title issued by Illinois. Lender perfects a security interest in the automobile by complying with Illinois' certificate-of-title statute. Thereafter, Debtor applies for a certificate of title in Indiana. Six months thereafter, Creditor acquires a judicial lien on the automobile. Under section 9-303(b), Illinois law ceases to govern perfection; rather, once Debtor delivers the application and applicable fee to the appropriate Indiana authority, Indiana law governs. Nevertheless, under Indiana's section 9-316(d), Lender's security interest remains perfected until it would become unperfected under Illinois law had no certificate of title been issued by Indiana. (For example, Illinois' certificate-of-title statute may provide that the surrender of an Illinois certificate of title in connection with the issuance of a certificate of title by another jurisdiction causes a security interest noted thereon to become unperfected.) If Lender's security interest remains perfected, it is senior to Creditor's judicial lien.

Example 9: Under the facts in Example 8, five months after Debtor applies for an Indiana certificate of title, Debtor sells the automobile to Buyer. Under subsection (e)(2), because Lender did not reperfect within the four months after the goods became covered by the Indiana certificate of title, Lender's security interest is deemed never to have been perfected against Buyer. Under section 9-317(b), Buyer is likely to take free of the security interest. Lender could have protected itself by perfecting its security interest either under Indiana's certificate-of-title statute, see section 9-311, or, if it had a right to do so under an agreement or section 9-609, by taking possession of the automobile. See section 9-313(b).

The results in examples 8 and 9 do not depend on the fact that the original perfection was achieved by notation on a certificate of title. Subsection (d) applies regardless of the method by which a security interest is perfected under the law of another jurisdiction when the goods became covered by a certificate of title from this state.

Section 9-337 affords protection to a limited class of persons buying or acquiring a security interest in the goods while a security interest is perfected under the law of another jurisdiction but after this state has issued a clean certificate of title.

6. **Deposit Accounts, Letter-of-Credit Rights, and Investment Property.** Subsections (f) and (g) address changes in the jurisdiction of a bank, issuer of an uncertificated security, issuer of or nominated person under a letter of credit, securities intermediary, and commodity intermediary. The provisions are analogous to those of subsections (a) and (b).

7. **Agricultural Liens.** This section does not apply to agricultural liens.

Example 10: Supplier holds an agricultural lien on corn. The lien arises under an Iowa statute. Supplier perfects by filing a financing statement in Iowa, where the corn is located. See section 9-302. Debtor stores the corn in Missouri. Assume the Iowa agricultural lien survives or an agricultural lien arises under Missouri law (matters that this article does not govern). Once the corn is located in Missouri, Missouri becomes the jurisdiction whose law governs perfection. See section 9-302. Thus, the agricultural lien will not be perfected unless Supplier files a financing statement in Missouri.

CASE NOTES

Four Month Period Tolled at Bankruptcy Filing. — Four-month window within which a creditor had to file financing papers after a debtor moved to a new jurisdiction was tolled when the bankruptcy filing occurred; good-faith transferees did not take the equipment at issue free from the creditors' liens, and the bankruptcy trustee took the equipment subject to the liens when he avoided the transactions to the good-faith transferees and recovered the equipment (decided under former G.S. 25-9-403). Whitaker v. CIT Group/Equip. Fin., Inc. (In re Crowell), 304 B.R. 255, 2004 U.S. Dist. LEXIS 1326 (W.D.N.C. 2004).

Cited in In re Augusta Tissue Mill, LLC, — Bankr. —, 2007 Bankr. LEXIS 3040 (Bankr. M.D.N.C. Sept. 5, 2007).

Subpart 3. Priority.

§ 25-9-317. Interests that take priority over or take free of security interest or agricultural lien.

(a) Conflicting security interests and rights of lien creditors. — A security interest or agricultural lien is subordinate to the rights of:

(1) A person entitled to priority under G.S. 25-9-322; and

(2) Except as otherwise provided in subsection (e) of this section, a person that becomes a lien creditor before the earlier of the time:

a. The security interest or agricultural lien is perfected; or

b. One of the conditions specified in G.S. 25-9-203(b)(3) is met and a financing statement covering the collateral is filed.

(b) Buyers that receive delivery. — Except as otherwise provided in subsection (e) of this section, a buyer, other than a secured party, of tangible chattel paper, tangible documents, goods, instruments, or a security certificate takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(c) Lessees that receive delivery. — Except as otherwise provided in subsection (e) of this section, a lessee of goods takes free of a security interest or agricultural lien if the lessee gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(d) Licensees and buyers of certain collateral. — A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, electronic documents, general intangibles, or investment property other than a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

(e) Purchase-money security interest. — Except as otherwise provided in G.S. 25-9-320 and G.S. 25-9-321, if a person files a financing statement with respect to a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing. (1945, c. 182, s. 4; c. 196, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1979, c. 404, s. 1; 1997-181, s. 8; 2000-169, s. 1; 2006-112, s. 53.)

OFFICIAL COMMENT

1. **Source.** Former sections 2A-307(2) and 9-301.

2. **Scope of This Section.** As did former section 9-301, this section lists the classes of persons who take priority over, or take free of, an unperfected security interest. Section 9-308 explains when a security interest or agricultural lien is "perfected." A security interest that has attached (see section 9-203) but as to which a required perfection step has not been taken is "unperfected." Certain provisions have been moved from former section 9-301. The definition of "lien creditor" now appears in section 9-102, and the rules governing priority in future advances are found in section 9-323.

3. **Competing Security Interests.** Section 9-322 states general rules for determining priority among conflicting security interests and refers to other sections that state special rules of priority in a variety of situations. The security interests given priority under section 9-322 and the other sections to which it refers take priority in general even over a perfected security interest. *A fortiori* they take priority over an unperfected security interest.

4. **Filed but Unattached Security Interest vs. Lien Creditor.** Under former section 9-301(1)(b), a lien creditor's rights had priority over an unperfected security interest. Perfection required attachment (former section 9-303), and attachment required the giving of value (former section 9-203). It followed that, if a secured party had filed a financing statement but the debtor had not entered into a security agreement and value had not yet been given, an intervening lien creditor whose lien arose after filing but before attachment of the security interest acquired rights that are senior to those of the secured party who later gives value. This result comported with the *nemo dat* concept: When the security interest attached, the collateral was already subject to the judicial lien.

On the other hand, this approach treated the first secured advance differently from all other advances, even in circumstances in which a security agreement covering the collateral had been entered into before the judicial lien attached. The special rule for future advances in former section 9-301(4) (substantially reproduced in section 9-323(b)) afforded priority to a discretionary advance made by a secured party within 45 days after the lien creditor's rights arose as long as the secured party was "perfected" when the lien creditor's lien arose—i.e., as long as the advance was not the first one and an earlier advance had been made.

Subsection (a)(2) revises former section 9-301(1)(b) and, in appropriate cases, treats the first advance the same as subsequent advances. More specifically, a judicial lien that arises after the security-agreement condition of section 9-203(b)(3) is satisfied and a financing statement is filed, but before the security interest attaches and becomes perfected, is subordinate to all advances secured by the security interest, even the first advance, except as otherwise provided in section 9-323(b). However, if the security interest becomes unperfected (e.g., because the effectiveness of the filed financing statement lapses) before the judicial lien arises, the security interest is subordinate. If a financing statement is filed but a security interest does not attach, then no priority contest arises. The lien creditor has the only enforceable claim to the property.

5. **Security Interest of Consignor or Receivables Buyer vs. Lien Creditor.** Section 1-201(37) defines "security interest" to include the interest of most true consignors of goods and the interest of most buyers of certain receivables (accounts, chattel paper, payment intangibles, and promissory notes). A consignee of goods or a seller of accounts or chattel paper each is deemed to have rights in the collateral which a lien creditor may reach, as long as the competing security interest of the consignor or buyer is unperfected. This is so even though, as between the consignor and the debtor-consignee, the latter has only limited rights, and, as between the buyer and debtor-seller, the latter does not have any rights in the collateral. See sections 9-318 (seller) and 9-319 (consignee). Security interests arising from sales of payment intangibles and promissory notes are automatically perfected. See section 9-309. Accordingly, a subsequent judicial lien always would be subordinate to the rights of a buyer of those types of receivables.

6. **Purchasers Other Than Secured Parties.** Subsections (b), (c), and (d) afford priority over an unperfected security interest to certain purchasers (other than secured parties) of collateral. They derive from former sections 9-301(1)(c), 9-301(1)(d), and 9-307(2). Former section 9-301(1)(c) and (1)(d) provided that unperfected security interests are "subordinate" to the rights of certain purchasers. But, as former comment 9 suggested, the practical effect of subordination in this context is that the purchaser takes free of the security interest. To avoid any possible misinterpretation, subsections (b) and (d) of this section use the phrase "takes free."

Subsection (b) governs goods, as well as intangibles of the type whose transfer is effected by physical delivery of the representative piece of paper (tangible chattel paper, documents, instruments, and security certificates). To obtain priority, a buyer must both give value and receive delivery of the collateral without knowledge of the existing security interest and before perfection. Even if the buyer gave value without knowledge and before perfection, the buyer would take subject to the security interest if perfection occurred before physical delivery of the collateral to the buyer. Subsection (c) contains a similar rule with respect to lessees of goods. Note that a lessee of goods in ordinary course of business takes free of all security interests created by the lessor, even if perfected. See section 9-321.

Normally, there will be no question when a buyer of chattel paper, documents, instruments, or security certificates "receives delivery" of the property. See section 1-201 (defining "delivery"). However, sometimes a buyer or lessee of goods, such as complex machinery, takes delivery of the goods in stages and completes assembly at its own location. Under those circumstances, the buyer or lessee "receives delivery" within the meaning of subsections (b) and (c) when, after an inspection of the portion of the goods remaining with the seller or lessor, it would be apparent to a potential lender to the seller or lessor that another person might have an interest in the goods.

The rule of subsection (b) obviously is not appropriate where the collateral consists of intangibles and there is no representative piece of paper whose physical delivery is the only or the customary method of transfer. Therefore, with respect to such intangibles (accounts, electronic chattel paper, general intangibles, and investment property other than certificated securities), subsection (d) gives priority to any buyer who gives value without knowledge, and before perfection, of the security interest. A licensee of a general intangible takes free of an unperfected security interest in the general intangible under the same circumstances. Note that a licensee of a general intangible in ordinary course of business takes rights under a nonexclusive license free of security interests created by the licensor, even if perfected. See section 9-321.

Unless section 9-109 excludes the transaction from this article, a buyer of accounts, chattel paper, payment intangibles, or promissory notes is a "secured party" (defined in section 9-102), and subsections (b) and (d) do not determine priority of the security interest created by the sale. Rather, the priority rules generally applicable to competing security interests apply. See section 9-322.

7. **Agricultural Liens.** Subsections (a), (b), and (c) subordinate unperfected agricultural liens in the same manner in which they subordinate unperfected security interests.

8. **Purchase-Money Security Interests.** Subsection (e) derives from former section 9-301(2). It provides that, if a purchase-money security interest is perfected by filing no later than 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of buyers, lessees, or lien creditors which arise between the time the security interest attaches and the time of filing. Subsection (e) differs from former section 9-301(2) in two significant respects. First, subsection (e) protects a purchase-money security interest against all buyers and lessees, not just against transferees in bulk. Second, subsection

(e) conditions this protection on filing within 20, as opposed to ten, days after delivery.

Section 9-311(b) provides that compliance with the perfection requirements of a statute or treaty described in section 9-311(a) "is equivalent to the filing of a financing statement." It follows that a person who perfects a security interest in goods covered by a certificate of title by complying with the perfection requirements of an applicable certificate-of-title statute "files a financing statement" within the meaning of subsection (e).

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 53, effective October 1, 2006, inserted "tangible" preceding "documents," in subsection (b); and inserted "electronic documents," in subsection (d).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

Registration Was Not Necessary Inter Partes. — A crop lien to secure agricultural advances was held valid inter partes, although not registered within the time required by statute. Gay v. Nash, 78 N.C. 100 (1878). See Reese & Co. v. Cole, 93 N.C. 87 (1885).

But registration of Crop Liens Was Necessary as to Third Parties. — See Gay v. Nash, 78 N.C. 100 (1878).

It was held that a mortgage on a crop, not expressed to be for advances, and not registered within the time formerly required, had no rights as an agricultural lien. Cooper v. Kimball, 123 N.C. 120, 31 S.E. 346 (1898).

Under North Carolina law a judicial lien creditor has priority over an unperfected lien on a personal property. In re Millerburg, 61 Bankr. 125 (Bankr. E.D.N.C. 1986).

One of the positions occupied by the bankruptcy trustee and debtor in possession is that of judicial lien creditor, and as between a Chapter 11 debtor in possession and a creditor with an unperfected lien on personal property, the debtor in possession will prevail. In re Millerburg, 61 Bankr. 125 (Bankr. E.D.N.C. 1986).

Judicial Lien Creditor's Rights Subordinate to Perfected Security Interest. — As a hypothetical judicial lien creditor, trustee's rights were subordinate to a properly perfected security interest. In re White, 183 Bankr. 713 (Bankr. M.D.N.C. 1995).

Lender with Perfected Security Interest in Note Had Priority Over Unperfected Lender of Same Note. — Where debtor used the same note as collateral for loans from two separate lenders, the lender with a perfected security interest in the note, due to his possession of it, had priority over the unperfected lender and was entitled to collect all or any portion of the note as agreed by the debtor until paid in full, and had no liability to the unperfected lender. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Former G.S. 25-9-301 did not establish the perfection date for security interests in vehicles, but rather established a grace period of 20 days after the debtor received possession of the collateral for perfection by filing of purchase money security interests in personal property. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

Creditor who did not file financing statement did not have perfected purchase money security interest in windows and gutters which were attached to and became a part of a house as over against the trustee in bankruptcy. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

Creditor's Inferior Lien. — Where creditor's admittedly unperfected lien was inferior to that of bankruptcy trustee, the value of the collateral to the creditor was zero, and the creditor had no allowed secured claim. In re

Therneau, 214 Bankr. 782 (Bankr. E.D.N.C. 1997).

Even though debtors took no affirmative steps to avoid creditor's unperfected lien, the viability of the unperfected lien became an issue when the debtors responded to the creditor's objection to the debtors' Chapter 13 plan, and the debtors were not required to file an objection or to use the valuation process to avoid the lien. In re Therneau, 214 Bankr. 782 (Bankr. E.D.N.C. 1997).

Interruption of Possession. — Where no exception was made to trial court's ruling that sheriff's levy (for plaintiff) interrupted defendant's possession of collateral, and defendant claimed perfected security interest in the property by possession, that ruling became the law of the case; therefore, since defendant's lien perfection was based only on possession of the collateral and sheriff's levy interrupted that possession in this case, court erred in finding defendant had priority over plaintiff, despite dicta by Court of Appeal indicating prior perfected security interest by possession would have priority over subsequent sheriff's levy of same property. Waterhouse v. Carolina Limousine Mfg., Inc., 96 N.C. App. 109, 384 S.E.2d 293, cert. denied, 326 N.C. 54, 389 S.E.2d 107 (1990).

Having an enforceable security interest does not necessarily mean that a secured party has a claim against insurer for those proceeds. The creditor's security interest in proceeds is enforceable against the debtor as soon as the proceeds are in the debtor's hands, and if continuously perfected, that interest is superior to the claims of intervening creditors from the moment insurance is payable. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Priority of Security Interests in Bankrupt's Equipment. — In an action to determine which of two creditors was entitled to money in trustee's possession resulting from the sale of the debtor's boat, the evidence supported the contention that the corporate debtor's boat was purchased by the bankrupt corporation, used by it and was to be considered "equipment" of the bankrupt rather than "consumer goods," so that the security interest of the first secured creditor in all present and future equipment owned by the bankrupt took priority over the security interest of the second creditor which was perfected more than 10 days after the bankrupt took possession of the boat. In re Boiling Springs Constr. Co., 3 Bankr. 251 (Bankr. E.D.N.C. 1980).

Landlord Perfecting Security Interest by Taking Possession Has Priority Over Selling Company. — In an action to determine the right of possession to a piece of property as between a landlord under a lease agreement and a company who sold the property under a conditional sales contract, neither party having filed a financing statement, the landlord, who perfected its security interest under the lease by taking possession of the property, had priority over the selling company. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

Lender with Perfected Security Interest in Note Had Priority Over Unperfected Lender of Same Note. — Where debtor used the same note as collateral for loans from two separate lenders, the lender with a perfected security interest in the note, due to his possession of it, had priority over the unperfected lender and was entitled to collect all or any portion of the note as agreed by the debtor until paid in full, and had no liability to the unperfected lender. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Where defendant had a perfected security interest in a note due to possession of that note when the maker thereof used the note as collateral to secure a loan from plaintiff, plaintiff's security agreement was subject to defendant's security interest. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Maker of a note secured by a deed of trust was obligated to make payments to possessor of the note and deed of trust until the note was paid in full. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Precedence of Agricultural Lien Over Prior Mortgage Lien. — An agricultural lien duly executed and registered took precedence over a mortgage of prior date and registration upon the "crops" therein subjected to the extent of the advances made. Wooten v. Hill, 98 N.C. 48, 3 S.E. 846 (1887); Killebrew v. Hines, 104 N.C. 182, 10 S.E. 159 (1889).

Cited in Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-318. No interest retained in right to payment that is sold; rights and title of seller of account or chattel paper with respect to creditors and purchasers.

(a) Seller retains no interest. — A debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.

(b) Deemed rights of debtor if buyer's security interest unperfected. — For purposes of determining the rights of creditors of, and purchasers for value of an account or chattel paper from, a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold. (2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** New.

2. **Sellers of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes.** Section 1-201(37) defines "security interest" to include the interest of a buyer of accounts, chattel paper, payment intangibles, or promissory notes. See also section 9-109(a) and comment 5. Subsection (a) makes explicit what was implicit, but perfectly obvious, under former article 9: The fact that a sale of an account or chattel paper gives rise to a "security interest" does not imply that the seller retains an interest in the property that has been sold. To the contrary, a seller of an account or chattel paper retains no interest whatsoever in the property to the extent that it has been sold. Subsection (a) also applies to sales of payment intangibles and promissory notes, transactions that were not covered by former article 9. Neither this article nor the definition of "security interest" in section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation.

3. **Buyers of Accounts and Chattel Paper.** Another aspect of sales of accounts and chattel paper also was implicit, and equally obvious, under former article 9: If the buyer's security interest is unperfected, then for purposes of determining the rights of certain third parties, the seller (debtor) is deemed to have all rights and title that the seller sold. The seller is deemed to have these rights even though, as between the parties, it has sold all its rights to the buyer. Subsection (b) makes this explicit. As a consequence of subsection (b), if the buyer's security interest is unperfected, the seller can transfer, and the creditors of the seller can reach, the account or chattel paper as if it had not been sold.

Example: Debtor sells accounts or chattel paper to Buyer-1 and retains no interest in them. Buyer-1 does not file a financing statement. Debtor then sells the same receivables to Buyer-2. Buyer-2 files a proper financing statement. Having sold the receivables to Buyer-1, Debtor would not have any rights in the collateral so as to permit Buyer-2's security (ownership) interest to attach. Nevertheless, under this section, for purposes of determining the rights of purchasers for value from Debtor, Debtor is deemed to have the rights that Debtor sold. Accordingly, Buyer-2's security interest attaches, is perfected by the filing, and, under section 9-322, is senior to Buyer-1's interest.

4. **Effect of Perfection.** If the security interest of a buyer of accounts or chattel paper is perfected the usual result would take effect: Transferees from and creditors of the seller could not acquire an interest in the sold accounts or chattel paper. The same result generally would occur if payment intangibles or promissory notes were sold, inasmuch as the buyer's security interest is automatically perfected under section 9-309. However, in certain circumstances a purchaser who takes possession of a promissory note will achieve priority, under Sections 9-330 or 9-331, over the security interest of an earlier buyer of the promissory note. It necessarily follows that the seller in those circumstances retains the power to transfer the promissory note, as if it had not been sold, to a purchaser who obtains priority under either of those sections. See Section 9-203(b)(3), Comment 6.

CASE NOTES

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-319. Rights and title of consignee with respect to creditors and purchasers.

(a) Consignee has consignor's rights. — Except as otherwise provided in subsection (b) of this section, for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) Applicability of other law. — For purposes of determining the rights of a creditor of a consignee, law other than this Article determines the rights and title of a consignee while goods are in the consignee's possession if, under this Part, a perfected security interest held by the consignor would have priority over the rights of the creditor. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Consignments.** This section takes an approach to consignments similar to that taken by section 9-318 with respect to buyers of accounts and chattel paper. Revised section 1-201(37) defines "security interest" to include the interest of a consignor of goods under many true consignments. Section 9-319(a) provides that, for purposes of determining the rights of certain third parties, the consignee is deemed to acquire all rights and title that the consignor had, if the consignor's security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods.

Insofar as creditors of the consignee are concerned, this article to a considerable extent reformulates the former law, which appeared in former sections 2-326 and 9-114, without changing the results. However, neither article 2 nor former article 9 specifically addresses the rights of nonordinary course buyers from the consignee. Former section 9-114 contained priority rules applicable to security interests in consigned goods. Under this article, the priority rules for purchase-money security interests in inventory apply to consignments. See section 9-103(d). Accordingly, a special section containing priority rules for consignments no longer is needed. Section 9-317 determines whether the rights of a judicial lien creditor are senior to the interest of the consignor, sections 9-322 and 9-324 govern competing security interests in consigned goods, and sections 9-315, 9-317, and 9-320 determine whether a buyer takes free of the consignor's interest.

The following example explains the operation of this section:

Example 1: SP-1 delivers goods to Debtor in a transaction constituting a "consignment" as defined in section 9-102. SP-1 does not file a financing statement. Debtor then grants a security interest in the goods to SP-2. SP-2 files a proper financing statement. Assuming Debtor is a mere bailee, as in a "true" consignment, Debtor would not have any rights in the collateral (beyond those of a bailee) so as to permit SP-2's security interest to attach to any greater rights. Nevertheless, under this section, for purposes of determining the rights of Debtor's creditors, Debtor is deemed to acquire SP-1's rights. Accordingly, SP-2's security interest attaches, is perfected by the filing, and, under section 9-322, is senior to SP-1's interest.

3. **Effect of Perfection.** Subsection (b) contains a special rule with respect to consignments that are perfected. If application of this article would result in the consignor having priority over a competing creditor, then other law determines the rights and title of the consignee.

Example 2: SP-1 delivers goods to Debtor in a transaction constituting a "consignment" as defined in section 9-102. SP-1 files a proper financing statement. Debtor then grants a security interest in the goods to SP-2. Under section 9-322, SP-1's security interest is senior to SP-2's. Subsection (b) indicates that, for purposes of determining SP-2's rights, other law determines the rights and title of the consignee. If, for example, a consignee obtains only the special property of a bailee, then SP-2's security interest would attach only to that special property.

Example 3: SP-1 obtains a security interest in all Debtor's existing and after-acquired inventory. SP-1 perfects its security interest with a proper filing. Then SP-2 delivers goods to Debtor in a transaction constituting a "consignment" as defined in section 9-102. SP-2 files a proper financing statement but does not send notification to SP-1 under section 9-324(b). Accordingly, SP-2's security interest is junior to SP-1's under section 9-322(a). Under section 9-319(a), Debtor is deemed to have the consignor's rights and title, so that SP-1's security interest attaches to SP-2's ownership interest in the goods. Thereafter, Debtor grants a security interest in the goods to SP-3, and SP-3 perfects by filing. Because SP-2's perfected security interest is senior to SP-3's under section 9-322(a), section 9-319(b) applies: Other law determines Debtor's rights and title to the goods insofar as SP-3 is concerned, and SP-3's security interest attaches to those rights.

§ 25-9-320. Buyer of goods.

(a) Buyer in ordinary course of business. — Except as otherwise provided in subsection (e) of this section, a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) Buyer of consumer goods. — Except as otherwise provided in subsection (e) of this section, a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys:

(1) Without knowledge of the security interest;
(2) For value;
(3) Primarily for the buyer's personal, family, or household purposes; and
(4) Before the filing of a financing statement covering the goods.

(c) Effectiveness of filing for subsection (b). — To the extent that it affects the priority of a security interest over a buyer of goods under subsection (b) of this section, the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by G.S. 25-9-316(a) and (b).

(d) Buyer in ordinary course of business at wellhead or minehead. — A buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(e) Possessory security interest not affected. — Subsections (a) and (b) of this section do not affect a security interest in goods in the possession of the secured party under G.S. 25-9-313. (1945, c. 182, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7.; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-307.

2. **Scope of This Section.** This section states when buyers of goods take free of a security interest even though perfected. Of course, a buyer who takes free of a perfected security interest takes free of an unperfected one. Section 9-317 should be consulted to determine what purchasers, in addition to the buyers covered in this section, take free of an unperfected security interest. Article 2 states general rules on purchase of goods from a seller with defective or voidable title (section 2-403).

3. **Buyers in Ordinary Course.** Subsection (a) derives from former section 9-307(1). The definition of "buyer in ordinary course of business" in section 1-201 restricts its application to buyers "from a person, other than a pawnbroker, in the business of selling goods of that kind." Thus subsection (a) applies primarily to inventory collateral. The subsection further excludes from its operation buyers of "farm products" (defined in section 9-102) from a person engaged in farming operations. The buyer in ordinary course of business is defined as one who buys goods "in good faith, without knowledge that the sale violates the rights of another person and in the ordinary course." Subsection (a) provides that such a buyer takes free of a security interest, even though perfected, and even though the buyer knows the security interest exists. Reading the definition together with the rule of law results in the buyer's

taking free if the buyer merely knows that a security interest covers the goods but taking subject if the buyer knows, in addition, that the sale violates a term in an agreement with the secured party.

As did former section 9-307(1), subsection (a) applies only to security interests created by the seller of the goods to the buyer in ordinary course. However, under certain circumstances a buyer in ordinary course who buys goods that were encumbered with a security interest created by a person other than the seller may take free of the security interest, as Example 2 explains. See also comment 6, below.

Example 1: Manufacturer, who is in the business of manufacturing appliances, owns manufacturing equipment subject to a perfected security interest in favor of Lender. Manufacturer sells the equipment to Dealer, who is in the business of buying and selling used equipment. Buyer buys the equipment from Dealer. Even if Buyer qualifies as a buyer in the ordinary course of business, Buyer does not take free of Lender's security interest under subsection (a), because Dealer did not create the security interest; Manufacturer did.

Example 2: Manufacturer, who is in the business of manufacturing appliances, owns manufacturing equipment subject to a perfected security interest in favor of Lender. Manufacturer sells the equipment to Dealer, who is in the business of buying and selling used equipment. Lender learns of the sale but does nothing to assert its security interest. Buyer buys the equipment from Dealer. Inasmuch as Lender's acquiescence constitutes an "entrusting" of the goods to Dealer within the meaning of section 2-403(3) Buyer takes free of Lender's security interest under section 2-403(2) if Buyer qualifies as a buyer in ordinary course of business.

4. **Buyers of Farm Products.** This section does not enable a buyer of farm products to take free of a security interest created by the seller, even if the buyer is a buyer in ordinary course of business. However, a buyer of farm products may take free of a security interest under section 1324 of the Food Security Act of 1985, 7 U.S.C. section 1631.

5. **Buyers of Consumer Goods.** Subsection (b), which derives from former section 9-307(2), deals with buyers of collateral that the debtor-seller holds as "consumer goods" (defined in section 9-102). Under section 9-309(1), a purchase-money interest in consumer goods, except goods that are subject to a statute or treaty described in section 9-311(a) (such as automobiles that are subject to a certificate-of-title statute), is perfected automatically upon attachment. There is no need to file to perfect. Under subsection (b) a buyer of consumer goods takes free of a security interest, even though perfected, if the buyer buys (1) without knowledge of the security interest, (2) for value, (3) primarily for the buyer's own personal, family, or household purposes, and (4) before a financing statement is filed.

As to purchase-money security interests which are perfected without filing under section 9-309(1): A secured party may file a financing statement, although filing is not required for perfection. If the secured party does file, all buyers take subject to the security interest. If the secured party does not file, a buyer who meets the qualifications stated in the preceding paragraph takes free of the security interest.

As to security interests for which a perfection step is required: This category includes all non-purchase-money security interests, and all security interests, whether or not purchase-money, in goods subject to a statute or treaty described in section 9-311(a), such as automobiles covered by a certificate-of-title statute. As long as the required perfection step has not been taken and the security interest remains unperfected, not only the buyers described in subsection (b) but also the purchasers described in section 9-317 will take free of the security interest. After a financing statement has been filed or the perfection requirements of the applicable certificate-of-title statute have been complied with (compliance is the equivalent of filing a financing statement; see section 9-311(b)), all subsequent buyers, under the rule of subsection (b), are subject to the security interest.

The rights of a buyer under subsection (b) turn on whether a financing statement has been filed against consumer goods. Occasionally, a debtor changes his or her location after a filing is made. Subsection (c), which derives from former section 9-103(1)(d)(iii), deals with the continued effectiveness of the filing under those circumstances. It adopts the rules of section 9-316(a) and (b). These rules are explained in the comments to that section.

6. **Authorized Dispositions.** The limitations that subsections (a) and (b) impose on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party authorized the sale in an express agreement or otherwise, the buyer takes free under section 9-315(a)(1) without regard to the limitations of this section. (That section also states the right of a secured party to the proceeds of a sale, authorized or unauthorized.) Moreover, the buyer also takes free if the secured party waived or otherwise is precluded from asserting its security interest against the buyer. See section 1-103.

7. **Oil, Gas, and Other Minerals.** Under subsection (d), a buyer in ordinary course of business of minerals at the wellhead or minehead or after extraction takes free of a security interest created by the seller. Specifically, it provides that qualified buyers take free

not only of article 9 security interests but also of interests "arising out of an encumbrance." As defined in section 9-102, the term "encumbrance" means "a right, other than an ownership interest, in real property." Thus, to the extent that a mortgage encumbers minerals not only before but also after extraction, subsection (d) enables a buyer in ordinary course of the minerals to take free of the mortgage. This subsection does not, however, enable these buyers to take free of interests arising out of ownership interests in the real property. This issue is significant only in a minority of states. Several of them have adopted special statutes and nonuniform amendments to article 9 to provide special protections to mineral owners, whose interests often are highly fractionalized in the case of oil and gas. See Terry I. Cross, Oil and Gas Product Liens—Statutory Security Interests for Producers and Royalty Owners Under the Statutes of Kansas, New Mexico, Oklahoma, Texas and Wyoming, 50 Consumer Fin. L. Q. Rep. 418 (1996). Inasmuch as a complete resolution of the issue would require the addition of complex provisions to this article, and there are good reasons to believe that a uniform solution would not be feasible, this article leaves its resolution to other legislation.

8. **Possessory Security Interests.** Subsection (e) is new. It rejects the holding of Tanbro Fabrics Corp. v. Deering Milliken, Inc., 350 N.E.2d 590 (N.Y. 1976) and, together with section 9-317(b), prevents a buyer of goods collateral from taking free of a security interest if the collateral is in the possession of the secured party. "The secured party" referred in subsection (e) is the holder of the security interest referred to in subsection (a) or (b). Section 9-313 determines whether a secured party is in possession for purposes of this section. Under some circumstances, section 9-313 provides that a secured party is in possession of collateral even if the collateral is in the physical possession of a third party.

Legal Periodicals. — For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For note on the standard of good faith for merchant buyers, see 51 N.C.L. Rev. 646 (1973).

For note on conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

For comment, "Entrustment Under U.C.C. Section 2-403 and its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

The UCC, as adopted in this State, protects purchasers in the ordinary course of business from the claims of predecessors in interest who place items into the stream of commerce without warning that they subsequently will claim ownership. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

A buyer takes free of a security interest created by the seller, even if he knows of the security interest, as long as the buyer does not know that the sale is in violation of some term of the security agreement. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Extent to Which Consumer Takes Free of Interest in Inventory. — Consumer takes free of a secured creditor's interest in a debtor's inventory only to the extent that title to the inventory has passed to the consumer. Abbott v. Blackwelder Furn. Co., 33 Bankr. 399 (W.D.N.C. 1983).

Security Interest in Motor Vehicles. — Provision that a buyer in ordinary course of business takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence is not operative in instances where perfection of the security interest is required under Chapter 20 on motor vehicles. Bank of Alamance v. Isley, 74 N.C. App. 489, 328 S.E.2d 867 (1985); North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Notwithstanding the title transfer provisions of the Motor Vehicle Act, an automobile purchaser may be a "buyer in the ordinary course of business" even though the certificate of title has not yet been reassigned. It was the Legislature's intent to have the UCC control issues of security interest and priorities. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

The UCC should control over the Motor Vehicle Act when automobiles are used as collateral and are held in inventory for sale. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

Buyers who gave value for a used car displayed on dealer's lot and received a 20-day temporary marker in June, 1983, which car was covered by a dealer inventory security agreement in effect since April 1, 1970, and on which the credit company retained the title certificate, which was in the name of the dealer, had a superior right to possession of the car when the credit company's agent came to repossess it on June 19, 1983, as it was no longer part of the dealer's inventory; and buyers were entitled to possession of the car in their action for wrongful conversion. North Carolina Nat'l Bank v. Robinson, 78 N.C. App. 1, 336 S.E.2d 666 (1985).

§ 25-9-321. Licensee of general intangible and lessee of goods in ordinary course of business.

(a) "Licensee in ordinary course of business". — In this section, "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the license to the person comports with the usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

(b) Rights of licensee in ordinary course of business. — A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor, even if the security interest is perfected and the licensee knows of its existence.

(c) Rights of lessee in ordinary course of business. — A lessee in ordinary course of business takes its leasehold interest free of a security interest in the goods created by the lessor, even if the security interest is perfected and the lessee knows of its existence. (1993, c. 463, s. 1; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Derived from sections 2A-103(1)(o) and 2A-307(3).

2. **Licensee in Ordinary Course.** Like the analogous rules in section 9-320(a) with respect to buyers in ordinary course and subsection (c) with respect to lessees in ordinary course, the new rule in subsection (b) reflects the expectations of the parties and the marketplace: A licensee under a nonexclusive license takes subject to a security interest unless the secured party authorizes the license free of the security interest or other, controlling law such as that of this section (protecting ordinary-course licensees) dictates a contrary result. See sections 9-201 and 9-315. The definition of "licensee in ordinary course of business" in subsection (a) is modeled upon that of "buyer in ordinary course of business."

3. **Lessee in Ordinary Course.** Subsection (c) contains the rule formerly found in section 2A-307(3). The rule works in the same way as that of section 9-320(a).

§ 25-9-322. Priorities among conflicting security interests in and agricultural liens on same collateral.

(a) General priority rules. — Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

(2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(b) Time of perfection: proceeds and supporting obligations. — For the purposes of subdivision (a)(1) of this section:

(1) The time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and

(2) The time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(c) Special priority rules: proceeds and supporting obligations. — Except as otherwise provided in subsection (f) of this section, a security interest in collateral which qualifies for priority over a conflicting security interest under G.S. 25-9-327, 25-9-328, 25-9-329, 25-9-330, or 25-9-331 also has priority over a conflicting security interest in:

(1) Any supporting obligation for the collateral; and

(2) Proceeds of the collateral if:

a. The security interest in proceeds is perfected;

b. The proceeds are cash proceeds or of the same type as the collateral; and

c. In the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral.

(d) First-to-file priority rule for certain collateral. — Subject to subsection (e) of this section and except as otherwise provided in subsection (f) of this section, if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(e) Applicability of subsection (d). — Subsection (d) of this section applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

(f) Limitations on subsections (a) through (e). — Subsections (a) through (e) of this section are subject to:

(1) Subsection (g) of this section and the other provisions of this Part;

(2) G.S. 25-4-208 with respect to a security interest of a collecting bank;

(3) G.S. 25-5-118 with respect to a security interest of an issuer or nominated person; and

(4) G.S. 25-9-110 with respect to a security interest arising under Article 2 or 2A of this Chapter.

(g) Priority under agricultural lien statute. — A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1; 1967, c. 24, s. 13; 1975, c. 862, s. 7; 1979, c. 404, s. 2; 1989 (Reg. Sess., 1990), c. 1024, s. 8(o); 1997-181, ss. 15, 16; 1997-336, s. 1; 1997-456, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-312(5), (6).

2. **Scope of This Section.** In a variety of situations, two or more people may claim a security interest in the same collateral. This section states general rules of priority among conflicting security interests. As subsection (f)

provides, the general rules in subsections (a) through (e) are subject to the rule in subsection (g) governing perfected agricultural liens and to the other rules in this part of this article. Rules that override this section include those applicable to purchase-money security interests (section 9-324) and those qualifying for special priority in particular types of collateral. See, e.g., section 9-327 (deposit accounts); section 9-328 (investment property); section 9-329 (letter-of-credit rights); section 9-330 (chattel paper and instruments); and section 9-334 (fixtures). In addition, the general rules of sections (a) through (e) are subject to priority rules governing security interests arising under articles 2, 2A, 4, and 5.

3. **General Rules.** Subsection (a) contains three general rules. Subsection (a)(1) governs the priority of competing perfected security interests. Subsection (a)(2) governs the priority of competing security interests if one is perfected and the other is not. Subsection (a)(3) governs the priority of competing unperfected security interests. The rules may be regarded as adaptations of the idea, deeply rooted at common law, of a race of diligence among creditors. The first two rules are based on precedence in the time as of which the competing secured parties either filed their financing statements or obtained perfected security interests. Under subsection (a)(1), the first secured party who files or perfects has priority. Under subsection (a)(2), which is new, a perfected security interest has priority over an unperfected one. Under subsection (a)(3), if both security interests are unperfected, the first to attach has priority. Note that section 9-709(b) may affect the application of subsection (a) to a filing that occurred before the effective date of this article (July 1, 2001) and which would be ineffective to perfect a security interest under former article 9 but effective under this article.

4. **Competing Perfected Security Interests.** When there is more than one perfected security interest, the security interests rank according to priority in time of filing or perfection. "Filing," of course, refers to the filing of an effective financing statement. "Perfection" refers to the acquisition of a perfected security interest, i.e., one that has attached and as to which any required perfection step has been taken. See sections 9-308 and 9-309.

Example 1: On February 1, A files a financing statement covering a certain item of Debtor's equipment. On March 1, B files a financing statement covering the same equipment. On April 1, B makes a loan to Debtor and obtains a security interest in the equipment. On May 1, A makes a loan to Debtor and obtains a security interest in the same collateral. A has priority even though B's loan was made earlier and was perfected when made. It makes no difference whether A knew of B's security interest when A made its advance.

The problem stated in Example 1 is peculiar to a notice-filing system under which filing may occur before the security interest attaches (see section 9-502). The justification for determining priority by order of filing lies in the necessity of protecting the filing system—that is, of allowing the first secured party who has filed to make subsequent advances without each time having to check for subsequent filings as a condition of protection. Note, however, that this first-to-file protection is not absolute. For example, section 9-324 affords priority to certain purchase-money security interests, even if a competing secured party was the first to file or perfect.

Example 2: A and B make non-purchase-money advances secured by the same collateral. The collateral is in Debtor's possession, and neither security interest is perfected when the second advance is made. Whichever secured party first perfects its security interest (by taking possession of the collateral or by filing) takes priority. It makes no difference whether that secured party knows of the other security interest at the time it perfects its own.

The rule of subsection (a)(1), affording priority to the first to file or perfect, applies to security interests that are perfected by any method, including temporarily (section 9-312) or upon attachment (section 9-309), even though there may be no notice to creditors or subsequent purchasers and notwithstanding any common-law rule to the contrary. The form of the claim to priority, i.e., filing or perfection, may shift from time to time, and the rank will be based on the first filing or perfection as long as there is no intervening period without filing or perfection. See section 9-308(c).

Example 3: On October 1, A acquires a temporarily perfected (20-day) security interest, unfiled, in a negotiable document in the debtor's possession under section 9-312(e). On October 5, B files and thereby perfects a security interest that previously had attached to the same document. On October 10, A files. A has priority, even after the 20-day period expires, regardless of whether A knows of B's security interest when A files. A was the first to perfect and maintained continuous perfection or filing since the start of the 20-day period. However, the perfection of A's security interest extends only "to the extent it arises for new value given." To the extent A's security interest secures advances made by A beyond the 20-day period, its security interest would be subordinate to B's, inasmuch as B was the first to file.

In general, the rule in subsection (a)(1) does not distinguish among various advances made by a secured party. The priority of every advance dates from the earlier of filing or perfection. However, in rare instances, the priority of an advance dates from the time the advance is made. See example 3 and section 9-323.

5. **Priority in After-Acquired Property.** The application of the priority rules to after-acquired property must be considered separately for each item of collateral. Priority does not depend only on time of perfection but may also be based on priority in filing before perfection.

Example 4: On February 1, A makes advances to Debtor under a security agreement covering "all Debtor's machinery, both existing and after-acquired." A promptly files a financing statement. On April 1, B takes a security interest in all Debtor's machinery, existing and after-acquired, to secure an outstanding loan. The following day, B files a financing statement. On May 1, Debtor acquires a new machine. When Debtor acquires rights in the new machine, both A and B acquire security interests in the machine simultaneously. Both security interests are perfected simultaneously. However, A has priority because A filed before B.

When after-acquired collateral is encumbered by more than one security interest, one of the security interests often is a purchase-money security interest that is entitled to special priority under section 9-324.

6. **Priority in Proceeds: General Rule.** Subsection (b)(1) follows former section 9-312(6). It provides that the baseline rules of subsection (a) apply generally to priority conflicts in proceeds except where otherwise provided (e.g., as in subsections (c) through (e)). Under section 9-203, attachment cannot occur (and therefore, under section 9-308, perfection cannot occur) as to particular collateral until the collateral itself comes into existence and the debtor has rights in it. Thus, a security interest in proceeds of original collateral does not attach and is not perfected until the proceeds come into existence and the debtor acquires rights in them.

Example 5: On April 1, Debtor authenticates a security agreement granting to A a security interest in all Debtor's existing and after-acquired inventory. The same day, A files a financing statement covering inventory. On May 1, Debtor authenticates a security agreement granting B a security interest in all Debtor's existing and future accounts. On June 1, Debtor sells inventory to a customer on 30-day unsecured credit. When Debtor acquires the account, B's security interest attaches to it and is perfected by B's financing statement. At the very same time, A's security interest attaches to the account as proceeds of the inventory and is automatically perfected. See section 9-315. Under subsection (b) of this section, for purposes of determining A's priority in the account, the time of filing as to the original collateral (April 1, as to inventory) is also the time of filing as to proceeds (account). Accordingly, A's security interest in the account has priority over B's. Of course, had B filed its financing statement before A filed (e.g., on March 1), then B would have priority in the accounts.

Section 9-324 governs the extent to which a special purchase-money priority in goods or software carries over into the proceeds of the original collateral.

7. **Priority in Proceeds: Special Rules.** Subsections (c), (d), and (e), which are new, provide additional priority rules for proceeds of collateral in situations where the temporal (first-in-time) rules of subsection (a)(1) are not appropriate. These new provisions distinguish what these comments refer to as "non-filing collateral" from what they call "filing collateral." As used in these comments, non-filing collateral is collateral of a type for which perfection may be achieved by a method other than filing (possession or control, mainly) and for which secured parties who so perfect generally do not expect or need to conduct a filing search. More specifically, non-filing collateral is chattel paper, deposit accounts, negotiable documents, instruments, investment property, and letter-of-credit rights. Other collateral—accounts, commercial tort claims, general intangibles, goods, nonnegotiable documents, and payment intangibles—is filing collateral.

8. **Proceeds of Non-Filing Collateral: Non-Temporal Priority.** Subsection (c)(2) provides a baseline priority rule for proceeds of non-filing collateral which applies if the secured party has taken the steps required for non-temporal priority over a conflicting security interest in non-filing collateral (e.g., control, in the case of deposit accounts, letter-of-credit rights, and investment property). This rule determines priority in proceeds of non-filing collateral whether or not there exists an actual conflicting security interest in the original non-filing collateral. Under subsection (c)(2), the priority in the original collateral continues in proceeds if the security interest in proceeds is perfected and the proceeds are cash proceeds or non-filing proceeds "of the same type" as the original collateral. As used in subsection (c)(2), "type" means a type of collateral defined in the Uniform Commercial Code and should be read broadly. For example, a security is "of the same type" as a security entitlement (i.e., investment property), and a promissory note is "of the same type" as a draft (i.e., an instrument).

Example 6: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. Debtor receives cash proceeds of the security (e.g., dividends deposited into Debtor's deposit account). If the first-to-file-or-perfect rule of subsection (a)(1) were applied, SP-1's security interest in the cash proceeds would be senior, although SP-2's security interest continues perfected under section 9-315 beyond the 20-day period of automatic perfection. This was the result under former article 9. Under subsection (c), however, SP-2's security interest is senior.

Note that a different result would obtain in Example 6 (i.e., SP-1's security interest would be senior) if SP-1 were to obtain control of the deposit-account proceeds. This is so because subsection (c) is subject to subsection (f), which in turn provides that the priority rules under subsections (a) through (e) are subject to "the other provisions of this part." One of those "other provisions" is section 9-327, which affords priority to a security interest perfected by control. See section 9-327(1).

Example 7: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. Debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend on the original collateral. Although the new security is of the same type as the original collateral (i.e., investment property), once the 20-day period of automatic perfection expires (see section 9-315(d)), SP-2's security interest is unperfected. (SP-2 has not filed or taken delivery or control, and no temporary-perfection rule applies.) Consequently, once the 20-day period expires, subsection (c) does not confer priority, and, under subsection (a)(2), SP-1's security interest in the security is senior. This was the result under former article 9.

Example 8: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. Debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend of the collateral. Because the new security is of the same type as the original collateral (i.e., investment property) and (unlike example 7) SP-2's security interest is perfected by filing, SP-2's security interest is senior under subsection (c). If the new security were redeemed by the issuer upon surrender and yet another security were received by Debtor, SP-2's security interest would continue to enjoy priority under subsection (c). The new security would be proceeds of proceeds.

Example 9: SP-1 perfects its security interest in investment property by filing. SP-2 subsequently perfects its security interest in investment property by taking control of a certificated security and also by filing against investment property. Debtor receives proceeds of the security consisting of a dividend check that it deposits to a deposit account. Because the check and the deposit account are cash proceeds, SP-1's and SP-2's security interests in the cash proceeds are perfected under section 9-315 beyond the 20-day period of automatic perfection. However, SP-2's security interest is senior under subsection (c).

Example 10: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. Debtor receives an instrument as proceeds of the security. (Assume that the instrument is not cash proceeds.) Because the instrument is not of the same type as the original collateral (i.e., investment property), SP-2's security interest, although perfected by filing, does not achieve priority under subsection (c). Under the first-to-file-or-perfect rule of subsection (a)(1), SP-1's security interest in the proceeds is senior.

The proceeds of proceeds are themselves proceeds. See section 9-102 (defining "proceeds" and "collateral"). Sometimes competing security interests arise in proceeds that are several generations removed from the original collateral. As the following example explains, the applicability of subsection (c) may turn on the nature of the intervening proceeds.

Example 11: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit account, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited into another deposit account, as to which SP-1 has not obtained control. Subsection (c) does not govern priority in this other deposit account. This deposit account is cash proceeds and is also the same type of collateral as SP-1's original collateral, as required by subsections (c)(2)(A) and (B). However, SP-1's security interest does not satisfy subsection (c)(2)(C) because the inventory proceeds, which intervened between the original deposit account and the deposit account constituting the proceeds at issue, are not cash proceeds, proceeds of the same type as the collateral (original deposit account), or an account relating to the collateral. Stated otherwise, once proceeds other than cash proceeds, proceeds of the same type as the original collateral, or an account relating to the original collateral intervene in the chain of proceeds, priority under subsection (c) is thereafter unavailable. The special priority rule in subsection (d) also is inapplicable to this case. See comment 9, example 13, below. Instead, the general first-to-file-or-perfect rule of subsections (a) and (b) apply. Under that rule, SP-1 has priority unless its security interest in the inventory proceeds became unperfected under section 9-315(d). Had SP-2 filed against inventory before SP-1 obtained control of the original deposit account, the SP-2 would have had priority even if SP-1's security interest in the inventory proceeds remained perfected.

9. **Proceeds of Nonfiling Collateral: Special Temporal Priority.** Under subsections (d) and (e), if a security interest in nonfiling collateral is perfected by a method other than filing (e.g., control or possession), it does not retain its priority over a conflicting security interest in proceeds that are filing collateral. Moreover, it is not entitled to priority in proceeds under the first-to-file-or-perfect rule of subsections (a)(1) and (b). Instead, under subsection (d), priority is determined by a new first-to-file rule.

Example 12: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against equipment, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's equipment. SP-1 then files against Debtor's equipment. Debtor uses funds from the deposit account to purchase equipment, which SP-1 can trace as proceeds of its security interest in Debtor's deposit account. If the first-to-file-or-perfect rule were applied, SP-1's security interest would be senior under subsections (a)(1) and (b), because it was the first to perfect in the original collateral and there was no period during which its security interest was unperfected. Under subsection (d), however, SP-2's security interest would be senior because it filed first. This corresponds with the likely expectations of the parties.

Note that under subsection (e), the first-to-file rule of subsection (d) applies only if the proceeds in question are other than nonfiling collateral (i.e., if the proceeds are filing collateral). If the proceeds are nonfiling collateral, either the first-to-file-or-perfect rule under subsections (a) and (b) or the nontemporal priority rule in subsection (c) would apply, depending on the facts.

Example 13: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit account, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited into another deposit account, as to which SP-1 has not obtained control. As discussed above in comment 8, example 11, subsection (c) does not govern priority in this deposit account. Subsection (d) also does not govern, because the proceeds at issue (the deposit account) are cash proceeds. See subsection (e). Rather, the general rules of subsections (a) and (b) govern.

10. **Priority in Supporting Obligations.** Under subsections (b)(2) and (c)(1), a security interest having priority in collateral also has priority in a supporting obligation for that collateral. However, the rules in these subsections are subject to the special rule in section 9-329 governing the priority of security interests in a letter-of-credit right. See subsection (f). Under section 9-329, a secured party's failure to obtain control (section 9-107) of a letter-of-credit right that serves as supporting collateral leaves its security interest exposed to a priming interest of a party who does take control.

11. **Unperfected Security Interests.** Under subsection (a)(3), if conflicting security interests are unperfected, the first to attach has priority. This rule may be of merely theoretical interest, inasmuch as it is hard to imagine a situation where the case would come into litigation without either secured party's having perfected its security interest. If neither security interest had been perfected at the time of the filing of a petition in bankruptcy, ordinarily neither would be good against the trustee in bankruptcy under the Bankruptcy Code.

12. **Agricultural Liens.** Statutes other than this article may purport to grant priority to an agricultural lien as against a conflicting security interest or agricultural lien. Under subsection (g), if another statute grants priority to an agricultural lien, the agricultural lien has priority only if the same statute creates the agricultural lien and the agricultural lien is perfected. Otherwise, subsection (a) applies the same priority rules to an agricultural lien as to a security interest, regardless of whether the agricultural lien conflicts with another agricultural lien or with a security interest.

Inasmuch as no agricultural lien on proceeds arises under this article, subsections (b) through (e) do not apply to proceeds of agricultural liens. However, if an agricultural lien has priority under subsection (g) and the statute creating the agricultural lien gives the secured party a lien on proceeds of the collateral subject to the lien, a court should apply the principle of subsection (g) and award priority in the proceeds to the holder of the perfected agricultural lien.

CASE NOTES

Priority Based On First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-323. Future advances.

(a) When priority based on time of advance. — Except as otherwise provided in subsection (c) of this section, for purposes of determining the priority of a perfected security interest under G.S. 25-9-322(a)(1), perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance that:

(1) Is made while the security interest is perfected only:
   a. Under G.S. 25-9-309 when it attaches; or
   b. Temporarily under G.S. 25-9-312(e), (f), or (g); and
(2) Is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under G.S. 25-9-309 or G.S. 25-9-312(e), (f), or (g).

(b) Lien creditor. — Except as otherwise provided in subsection (c) of this section, a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:

(1) Without knowledge of the lien; or
(2) Pursuant to a commitment entered into without knowledge of the lien.

(c) Buyer of receivables. — Subsections (a) and (b) of this section do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor.

(d) Buyer of goods. — Except as otherwise provided in subsection (e) of this section, a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

(1) The time the secured party acquires knowledge of the buyer's purchase; or
(2) 45 days after the purchase.

(e) Advances made pursuant to commitment: priority of buyer of goods. — Subsection (d) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45-day period.

(f) Lessee of goods. — Except as otherwise provided in subsection (g) of this section, a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

(1) The time the secured party acquires knowledge of the lease; or
(2) 45 days after the lease contract becomes enforceable.

(g) Advances made pursuant to commitment: priority of lessee of goods. — Subsection (f) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period. (1945, c. 182, s. 4; c. 196, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1979, c. 404, s. 1; 1997-181, s. 8; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 2A-307(4), 9-301(4), 9-307(3), and 9-312(7).

2. **Scope of This Section.** A security agreement may provide that collateral secures future advances. See section 9-204(c). This section collects all of the special rules dealing with the priority of advances made by a secured party after a third party acquires an interest in the collateral. Subsection (a) applies when the third party is a competing secured party. It replaces and clarifies former section 9-312(7). Subsection (b) deals with lien creditors and replaces former section 9-301(4). Subsections (d) and (e) deal with buyers and replace former section 9-307(3). Subsections (f) and (g) deal with lessees and replace former section 2A-307(4).

3. **Competing Security Interests.** Under a proper reading of the first-to-file-or-perfect rule of section 9-322(a)(1) (and former section 9-312(5)), it is abundantly clear that the time when an advance is made plays no role in determining priorities among conflicting security interests except when a financing statement was not filed and the advance is the giving of value as the last step for attachment and perfection. Thus, a secured party takes subject to all advances secured by a competing security interest having priority under section 9-322(a)(1). This result generally obtains regardless of how the competing security interest is perfected and regardless of whether the advances are made "pursuant to commitment" (section 9-102). Subsection (a) of this section states the only other instance when the time of an advance figures in the priority scheme in section 9-322: When the security interest is perfected only automatically under section 9-309 or temporarily under section 9-312(e), (f), or (g), and the advance is not made pursuant to a commitment entered into while the security interest was perfected by another method. Thus, an advance has priority from the date it is made only in the rare case in which it is made without commitment and while the security interest is perfected only temporarily under section 9-312.

The new formulation in subsection (a) clarifies the result when the initial advance is paid and a new ("future") advance is made subsequently. Under former section 9-312(7), the priority of the new advance turned on whether it was "made while a security interest is perfected." This section resolves any ambiguity by omitting the quoted phrase.

Example 1: On February 1, A makes an advance secured by machinery in the debtor's possession and files a financing statement. On March 1, B makes an advance secured by the same machinery and files a financing statement. On April 1, A makes a further advance, under the original security agreement, against the same machinery. A was the first to file and so, under the first-to-file-or-perfect rule of section 9-322(a)(1), A's security interest has priority over B's, both as to the February 1 and as to the April 1 advance. It makes no difference whether A knows of B's intervening advance when A makes the second advance. Note that, as long as A was the first to file or perfect, A would have priority with respect to both advances if either A or B had perfected by taking possession of the collateral. Likewise, A would have priority if A's April 1 advance was not made under the original agreement with the debtor, but was under a new agreement.

Example 2: On October 1, A acquires a temporarily perfected (20-day) security interest, unfiled, in a negotiable document in the debtor's possession under section 9-312(e) or (f). The security interest secures an advance made on that day as well as future advances. On October 5, B files and thereby perfects a security interest that previously had attached to the same document. On October 8, A makes an additional advance. On October 10, A files. Under section 9-322(a)(1), because A was the first to perfect and maintained continuous perfection or filing since the start of the 20-day period, A has priority, even after the 20-day period expires. See section 9-322, comment 4, example 3. However, under this section, for purposes of section 9-322(a)(1), to the extent A's security interest secures the October 8 advance, the security interest was perfected on October 8. Inasmuch as B perfected on October 5, B has priority over the October 8 advance.

The rule in subsection (a) is more liberal toward the priority of future advances than the corresponding rules applicable to intervening lien creditors (subsection (b)), buyers (subsections (d) and (e)), and lessees (subsections (f) and (g)).

4. **Competing Lien Creditors.** Subsection (b) replaces former section 9-301(4) and addresses the rights of a "lien creditor," as defined in Section 9-102. Under Section 9-317(a)(2), a security interest is senior to the rights of a person who becomes a lien creditor, unless the person becomes a lien creditor before the security interest is perfected and before a financing statement covering the collateral is filed and Sections 9-203(b)(3) is satisfied. Subsection (b) of this section provides that a security interest is subordinate to those rights to the extent the the specified circumstances occur. Subsection (b) does not elevate the priority of a security interest that is subordinate to the rights of a lien creditor under Section 9-317(a)(2); it only subordinates.

As under former section 9-301(4), a secured party's knowledge does not cut short the 45-day period during which future advances can achieve priority over an intervening lien creditor's interest. Rather, because of the impact of the rule in subsection (b) on the question whether the security interest for future advances is "protected" under section 6323(c)(2) and (d) of the Internal Revenue Code as amended by the Federal Tax Lien Act of 1966, the priority of the security interest for future advances over a lien creditor is made absolute for 45 days regardless of knowledge of the secured party concerning the lien. If, however, the advance is made after the 45 days, the advance will not have priority unless it was made or committed without knowledge of the lien.

5. **Sales of Receivables; Consignments.** Subsections (a) and (b) do not apply to outright sales of accounts, chattel paper, payment intangibles, or promissory notes, nor do they apply to consignments.

6. **Competing Buyers and Lessees.** Under subsections (d) and (e), a buyer will not take subject to a security interest to the extent it secures advances made after the secured party has knowledge that the buyer has purchased the collateral or more than 45 days after the purchase unless the advances were made pursuant to a commitment entered into before the expiration of the 45-day period and without knowledge of the purchase. Subsections (f) and (g) provide an analogous rule for lessees. Of course, a buyer in ordinary course who takes free of the security interest under section 9-320 and a lessee in ordinary course who takes free under section 9-321 are not subject to any future advances. Subsections (d) and (e) replace former section 9-307(3), and subsections (f) and (g) replace former section 2A-307(4). No change in meaning is intended.

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Second Loan as Future Advance. — To the extent the second loan may have placed an additional burden on the collateral, it must be considered a future advance. If the second loan was intended by the parties to extinguish the first obligation, the entire amount of the second obligation would be considered a future advance. Spector United Employees Credit Union v. Smith, 45 N.C. App. 432, 263 S.E.2d 319 (1980).

In an action to determine whether plaintiff lender was entitled to possession of personal property used to secure a loan which was subsequently sold to a third party, the trial court erred in granting summary judgment for plaintiff where a genuine issue of fact existed as to whether plaintiff and defendant borrower intended their loan transaction of June, 1977 to renew, enlarge or extinguish the note executed in April, 1976 by borrower which was secured by the property in question, since the nature of the second loan determined whether it was a future advance and thus whether defendant purchaser from defendant borrower took the property in question free from plaintiff lender's security interest. Spector United Employees Credit Union v. Smith, 45 N.C. App. 432, 263 S.E.2d 319 (1980).

§ 25-9-324. Priority of purchase-money security interests.

(a) General rule: purchase-money priority. — Except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in G.S. 25-9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

(b) Inventory purchase-money priority. — Subject to subsection (c) of this section and except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in G.S. 25-9-330, and, except as otherwise provided in G.S. 25-9-327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

(1) The purchase-money security interest is perfected when the debtor receives possession of the inventory;
(2) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
(3) The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and
(4) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(c) Holders of conflicting inventory security interests to be notified. — Subdivisions (b)(2) through (b)(4) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:
(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or
(2) If the purchase-money security interest is temporarily perfected without filing or possession under G.S. 25-9-312(f), before the beginning of the 20-day period thereunder.

(d) Livestock purchase-money priority. — Subject to subsection (e) of this section and except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in G.S. 25-9-327, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority, if:
(1) The purchase-money security interest is perfected when the debtor receives possession of the livestock;
(2) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
(3) The holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and
(4) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.

(e) Holders of conflicting livestock security interests to be notified. — Subdivisions (d)(2) through (d)(4) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:
(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or
(2) If the purchase-money security interest is temporarily perfected without filing or possession under G.S. 25-9-312(f), before the beginning of the 20-day period thereunder.

(f) Software purchase-money priority. — Except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in G.S. 25-9-327, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

(g) Conflicting purchase-money security interests. — If more than one security interest qualifies for priority in the same collateral under subsection (a), (b), (d), or (f) of this section:

(1) A security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral; and

(2) In all other cases, G.S. 25-9-322(a) applies to the qualifying security interests. (1945, c. 182, s. 4; c. 196, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1979, c. 404, s. 1; 1997-181, s. 8; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-312(3) and (4).

2. **Priority of Purchase-Money Security Interests.** This section contains the priority rules applicable to purchase-money security interests, as defined in section 9-103. It affords a special, nontemporal priority to those purchase-money security interests that satisfy the statutory conditions. In most cases, priority will be over a security interest asserted under an after-acquired property clause. See section 9-204 on the extent to which security interests in after-acquired property are validated.

A purchase-money security interest can be created only in goods and software. See section 9-103. Section 9-324(a), which follows former section 9-312(4), contains the general rule for purchase-money security interests in goods. It is subject to subsections (b) and (c), which derive from former section 9-312(3) and apply to purchase-money security interests in inventory, and subsections (d) and (e), which apply to purchase-money security interests in livestock that are farm products. Subsection (f) applies to purchase-money security interests in software. Subsection (g) deals with the relatively unusual case in which a debtor creates two purchase-money security interests in the same collateral and both security interests qualify for special priority under one of the other subsections.

Former section 9-312(2) contained a rule affording special priority to those who provided secured credit that enabled a debtor to produce crops. This rule proved unworkable and has been eliminated from this article. Instead, model section 9-324A contains a revised production-money priority rule. That section is a model, not uniform, provision. The sponsors of the UCC have taken no position as to whether it should be enacted, instead leaving the matter for state legislatures to consider if they are so inclined.

3. **Purchase-Money Priority in Goods Other Than Inventory and Livestock.** Subsection (a) states a general rule applicable to all types of goods except inventory and farm-products livestock: The purchase-money interest takes priority if it is perfected when the debtor receives possession of the collateral or within 20 days thereafter. (As to the 20-day "grace period," compare section 9-317(e). Former sections 9-301(2) and 9-312(4) contained a 10-day grace period.) The perfection requirement means that the purchase-money secured party either has filed a financing statement before that time or has a temporarily perfected security interest in goods covered by documents under section 9-312(e) and (f) which is continued in a perfected status by filing before the expiration of the 20-day period specified in that section. A purchase-money security interest qualifies for priority under subsection (a), even if the purchase-money secured party knows that a conflicting security interest has been created and/or that the holder of the conflicting interest has filed a financing statement covering the collateral.

Normally, there will be no question when "the debtor receives possession of the collateral" for purposes of subsection (a). However, sometimes a debtor buys goods and takes possession of them in stages, and then assembly and testing are completed (by the seller or debtor-buyer) at the debtor's location. Under those circumstances, the buyer "takes possession" within the meaning of subsection (a) when, after an inspection of the portion of the goods in the debtor's possession, it would be apparent to a potential lender to the debtor that the debtor has acquired an interest in the goods taken as a whole.

A similar issue concerning the time when "the debtor receives possession" arises when a person acquires possession of goods under a transaction that is not governed by this article and then later agrees to buy the goods on secured credit. For example, a person may take possession of goods as lessee under a lease contract and then exercise an option to purchase the goods from the lessor on secured credit. Under section 2A-307(1), creditors of the lessee generally take subject to the lease contract; filing a financing statement against the lessee is unnecessary to protect the lessor's leasehold or residual interest. Once the lease is converted to a security interest, filing a financing statement is necessary to protect the seller's (former lessor's) security interest. Accordingly, the 20-day period in subsection (a) does not commence until the goods become "collateral" (defined in section 9-102), i.e., until they are subject to a security interest.

4. **Purchase-Money Security Interests in Inventory.** Subsections (b) and (c) afford a means by which a purchase-money security interest in inventory can achieve priority over an earlier-filed security interest in the same collateral. To achieve priority, the purchase-money security interest must be perfected when the debtor receives possession of the inventory. For a discussion of when "the debtor receives possession," see comment 3, above. The 20-day grace period of subsection (a) does not apply.

The arrangement between an inventory secured party and its debtor typically requires the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though it has already given a purchase-money security interest in the inventory to another secured party. For this reason, subsections (b)(2) through (4) and (c) impose a second condition for the purchase-money security interest's achieving priority: The purchase-money secured party must give notification to the holder of a conflicting security interest who filed against the same item or type of inventory before the purchase-money secured party filed or its security interest became perfected temporarily under section 9-312(e) or (f). The notification requirement protects the non-purchase-money inventory secured party in such a situation: If the inventory secured party has received notification, it presumably will not make an advance; if it has not received notification (or if the other security interest does not qualify as purchase-money), any advance the inventory secured party may make ordinarily will have priority under section 9-322. Inasmuch as an arrangement for periodic advances against incoming goods is unusual outside the inventory field, subsection (a) does not contain a notification requirement.

5. **Notification to Conflicting Inventory Secured Party: Timing.** Under subsection (b)(3), the perfected purchase-money security interest achieves priority over a conflicting security interest only if the holder of the conflicting security interest receives a notification within five years before the debtor receives possession of the purchase-money collateral. If the debtor never receives possession, the five-year period never begins, and the purchase-money security interest has priority, even if notification is not given. However, where the purchase-money inventory financing began by the purchase-money secured party's possession of a negotiable document of title, to retain priority the secured party must give the notification required by subsection (b) at or before the usual time, i.e., when the debtor gets possession of the inventory, even though the security interest remains perfected for 20 days under section 9-312(e) or (f).

Some people have mistakenly read former section 9-312(3)(b) to require, as a condition of purchase-money priority in inventory, that the purchase-money secured party give the notification before it files a financing statement. Read correctly, the "before" clauses compare (i) the time when the holder of the conflicting security interest filed a financing statement with (ii) the time when the purchase-money security interest becomes perfected by filing or automatically perfected temporarily. Only if (i) occurs before (ii) must notification be given to the holder of the conflicting security interest. Subsection (c) has been rewritten to clarify this point.

6. **Notification to Conflicting Inventory Secured Party: Address.** Inasmuch as the address provided as that of the secured party on a filed financing statement is an "address that is reasonable under the circumstances," the holder of a purchase-money security interest may satisfy the requirement to "send" notification to the holder of a conflicting security interest in inventory by sending a notification to that address, even if the address is or becomes incorrect. See section 9-102 (definition of "send"). Similarly, because the address is "held out by (the holder of the conflicting security interest) as the place for receipt of such communications (i.e., communications relating to security interests)," the holder is deemed to have "received" a notification delivered to that address. See section 1-201(26).

7. **Consignments.** Subsections (b) and (c) also determine the priority of a consignor's interest in consigned goods as against a security interest in the goods created by the consignee. Inasmuch as a consignment subject to this article is defined to be a purchase-money security interest, see section 9-103(d), no inference concerning the nature of the transaction should be drawn from the fact that a consignor uses the term "security interest" in its notice under subsection (b)(4). Similarly, a notice stating that the consignor has delivered or expects to deliver goods, properly described, "on consignment" meets the requirements of subsection (b)(4), even if it does not contain the term "security interest," and even if the transaction subsequently is determined to be a security interest. Cf. section 9-505 (use of "consignor" and "consignee" in financing statement).

8. **Priority in Proceeds: General.** When the purchase-money secured party has priority over another secured party, the question arises whether this priority extends to the proceeds of the original collateral. Subsections (a), (d), and (f) give an affirmative answer, but only as to proceeds in which the security interest is perfected (see section 9-315). Although this qualification did not appear in former section

9-312(4), it was implicit in that provision.

In the case of inventory collateral under subsection (b), where financing frequently is based on the resulting accounts, chattel paper, or other proceeds, the special priority of the purchase-money secured interest carries over into only certain types of proceeds. As under former section 9-312(3), the purchase-money priority in inventory under subsection (b) carries over into identifiable cash proceeds (defined in section 9-102) received on or before the delivery of the inventory to a buyer.

As a general matter, also like former section 9-312(3), the purchase-money priority in inventory does not carry over into proceeds consisting of accounts or chattel paper. Many parties financing inventory are quite content to protect their first-priority security interest in the inventory itself. They realize that when the inventory is sold, someone else will be financing the resulting receivables (accounts or chattel paper), and the priority for inventory will not run forward to the receivables constituting the proceeds. Indeed, the cash supplied by the receivables financer often will be used to pay the inventory financing. In some situations, the party financing the inventory on a purchase-money basis makes contractual arrangements that the proceeds of receivables financing by another be devoted to paying off the inventory security interest.

However, the purchase-money priority in inventory does carry over to proceeds consisting of chattel paper and its proceeds (and also to instruments) to the extent provided in section 9-330. Under section 9-330(e), the holder of a purchase-money security interest in inventory is deemed to give new value for proceeds consisting of chattel paper. Taken together, sections 9-324(b) and 9-330(e) enable a purchase-money inventory secured party to obtain priority in chattel paper constituting proceeds of the inventory, even if the secured party does not actually give new value for the chattel paper, provided the purchase-money secured party satisfies the other conditions for achieving priority.

When the proceeds of original collateral (goods or software) consist of a deposit account, section 9-327 governs priority to the extent it conflicts with the priority rules of this section.

9. **Priority in Accounts Constituting Proceeds of Inventory.** The application of the priority rules in subsection (b) is shown by the following examples:

Example 1: Debtor creates a security interest in its existing and after-acquired inventory in favor of SP-1, who files a financing statement covering inventory. SP-2 subsequently takes a purchase-money security interest in certain inventory and, under subsection (b), achieves priority in this inventory over SP-1. This inventory is then sold, producing accounts. Accounts are not cash proceeds, and so the special purchase-money priority in the inventory does not control the priority in the accounts. Rather, the first-to-file-or-perfect rule of section 9-322(a)(1) applies. The time of SP-1's filing as to the inventory is also the time of filing as to the accounts under section 9-322(b). Assuming that each security interest in the accounts proceeds remains perfected under section 9-315, SP-1 has priority as to the accounts.

Example 2: In Example 1, if SP-2 had filed directly against accounts, the date of that filing as to accounts would be compared with the date of SP-1's filing as to the inventory. The first filed would prevail under section 9-322(a)(1).

Example 3: If SP-3 had filed against accounts in Example 1 before either SP-1 or SP-2 filed against inventory, SP-3's filing against accounts would have priority over the filings of SP-1 and SP-2. This result obtains even though the filings against inventory are effective to continue the perfected status of SP-1's and SP-2's security interest in the accounts beyond the 20-day period of automatic perfection. See section 9-315. SP-1's and SP-2's position as to the inventory does not give them a claim to accounts (as proceeds of the inventory) which is senior to someone who has filed earlier against accounts. If, on the other hand, either SP-1's or SP-2's filing against the inventory preceded SP-3's filing against accounts, SP-1 or SP-2 would outrank SP-3 as to the accounts.

10. **Purchase-Money Security Interests in Livestock.** New subsections (d) and (e) provide a purchase-money priority rule for farm-products livestock. They are patterned on the purchase-money priority rule for inventory found in subsections (b) and (c) and include a requirement that the purchase-money secured party notify earlier-filed parties. Two differences between subsections (b) and (d) are noteworthy. First, unlike the purchase-money inventory lender, the purchase-money livestock lender enjoys priority in all proceeds of the collateral. Thus, under subsection (d), the purchase-money secured party takes priority in accounts over an earlier-filed accounts financer. Second, subsection (d) affords priority in certain products of the collateral as well as proceeds.

11. **Purchase-Money Security Interests in Aquatic Farm Products.** Aquatic goods produced in aquacultural operations (e.g., catfish raised on a catfish farm) are farm products. See section 9-102 (definition of "farm products"). The definition does not indicate whether aquatic goods are "crops," as to which the model production money security interest priority in section 9-324A applies, or "livestock," as to which the purchase-money priority in subsection (d) of this section applies. This article leaves courts free to determine the classification of particular aquatic goods on a case-by-

case basis, applying whichever priority rule makes more sense in the overall context of the debtor's business.

12. **Purchase-Money Security Interests in Software.** Subsection (f) governs the priority of purchase-money security interests in software. Under section 9-103(c), a purchase-money security interest arises in software only if the debtor acquires its interest in the software for the principal purpose of using the software in goods subject to a purchase-money security interest. Under subsection (f), a purchase-money security interest in software has the same priority as the purchase-money security interest in the goods in which the software was acquired for use. This priority is determined under subsections (b) and (c) (for inventory) or (a) (for other goods).

13. **Multiple Purchase-Money Security Interests.** New subsection (g) governs priority among multiple purchase-money security interests in the same collateral. It grants priority to purchase-money security interests securing the price of collateral (i.e., created in favor of the seller) over purchase-money security interests that secure enabling loans. Section 7.2(c) of the Restatement (3d) of the Law of Property (Mortgages) (1997) adopts this rule with respect to real property mortgages. As comment d to that section explains:

> the equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it at all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price. This is the case even though the vendor may know that the mortgagor is going to finance the transaction in part by borrowing from a third party and giving a mortgage to secure that obligation. In the final analysis, the law is more sympathetic to the vendor's hazard of losing real estate previously owned than to the third party lender's risk of being unable to collect from an interest in real estate that never previously belonged to it.

The first-to-file-or-perfect rule of section 9-322 applies to multiple purchase-money security interests securing enabling loans.

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

As to when consignor was required to file under former Article 9, see BFC Chems., Inc. v. Smith-Douglass, Inc., 46 Bankr. 1009 (E.D.N.C. 1985).

Where a bank had no notice of a loan collateral sale that a bankruptcy court consented to allow, the bank could collaterally attack the consent order; as the bank had priority with a superior interest in the collateral, it was entitled to summary judgment over the company who sold the collateral. First-Citizens Bank & Trust Co. v. Four Oaks Bank & Trust Co., 156 N.C. App. 378, 576 S.E.2d 722, 2003 N.C. App. LEXIS 127 (2003).

§ 25-9-324.1. Priority of production-money security interests and agricultural liens.

(a) Priority over conflicting security interests. — Except as otherwise provided in subsections (c), (d), and (e) of this section, if the requirements of subsection (b) of this section are satisfied, a perfected production-money security interest in production-money crops has priority over a conflicting security interest in the same crops and, except as otherwise provided in G.S. 25-9-327, also has priority in their identifiable proceeds.

(b) Requirements for priority. — A production-money security interest has priority under subsection (a) of this section if:

(1) The production-money security interest is perfected by filing when the production-money secured party first gives new value to enable the debtor to produce the crops;

(2) The production-money secured party sends an authenticated notification to the holder of the conflicting security interest not less than 10 or more than 30 days before the production-money secured party first gives new value to enable the debtor to produce the crops if the holder had filed a financing statement covering the crops before the date of the filing made by the production-money secured party; and

(3) The notification states that the production-money secured party has or expects to acquire a production-money security interest in the debtor's crops and provides a description of the crops.

(c) Multiple production-money security interests. — Except as otherwise provided in subsection (d) or (e) of this section, if more than one security interest qualifies for priority in the same collateral under subsection (a) of this section, the security interests rank according to priority in time of filing under G.S. 25-9-322(a).

(d) New value to produce production-money crops. — To the extent that a person holding a perfected security interest in production-money crops that are the subject of a production-money security interest gives new value to enable the debtor to produce the production-money crops and the value is in fact used for the production of the production-money crops, the security interests rank according to priority in time of filing under G.S. 25-9-322(a).

(e) Holder of agricultural lien and production-money security interest. — To the extent that a person holds both an agricultural lien and a production-money security interest in the same collateral securing the same obligations, the rules of priority applicable to agricultural liens govern priority.

(f) Creating or perfecting production-money security interest not to operate as default or accelerating event. — Creating or perfecting a production-money security interest shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of any note or other instrument or agreement of any kind or nature to pay debt, any loan or credit agreement, or any security agreement or arrangement of any kind or nature where the collateral is real or personal property. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1; 1967, c. 24, s. 13; 1975, c. 862, s. 7; 1979, c. 404, s. 2; 1989 (Reg. Sess., 1990), c. 1024, s. 8(o); 1997-181, ss. 15, 16; 1997-336, s. 1; 1997-456, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; replaces former Section 9-312(2).

2. **Priority of Production-Money Security Interests and Conflicting Security Interests.** This section replaces the limited priority in crops afforded by former Section 9-312(2). That priority generally has been thought to be of little value for its intended beneficiaries. This section attempts to balance the interests of the production-money secured party with those of a secured party who has previously filed a financing statement covering the crops that are to be produced. For example, to qualify for priority under this section, the production-money secured party must notify the earlier-filed secured party prior to extending the production-money credit. The notification affords the earlier secured party the opportunity to prevent subordination by extending the credit itself. Subsection (d) makes this explicit. If the holder of a security interest in production-money crops which conflicts with a production-money security interest gives new value for the production of the crops, the security interests rank according to priority in time of filing under Section 9-322(a).

3. **Multiple Production-Money Security Interest.** In the case of multiple production-money security interests that qualify for priority under subsection (a), the first to file has priority. See subsection (c). Note that only a security interest perfected by filing is entitled to production-money priority. See subsection (b)(1). Consequently, subsection (c) does not adopt the first-to-file-or-perfect formulation.

4. **Holder of Agricultural Lien and Production-Money Security Interest.** Subsection (e) deals with a creditor who holds both an agricultural lien and an Article 9 production-money security interest in the same collateral. In these cases, the priority rules applicable to agricultural liens govern. The creditor can avoid this result by waiving its agricultural lien.

NORTH CAROLINA COMMENT

This section was adapted from the uniform text's optional model provisions for production-money priority. Subsection (f) has no counterpart in the uniform text.

§ 25-9-325. Priority of security interests in transferred collateral.

(a) Subordination of security interest in transferred collateral. — Except as otherwise provided in subsection (b) of this section, a security interest created by a debtor is subordinate to a security interest in the same collateral created by another person if:

(1) The debtor acquired the collateral subject to the security interest created by the other person;

(2) The security interest created by the other person was perfected when the debtor acquired the collateral; and

(3) There is no period thereafter when the security interest is unperfected.

(b) Limitation of subsection (a) subordination. — Subsection (a) of this section subordinates a security interest only if the security interest:

(1) Otherwise would have priority solely under G.S. 25-9-322(a) or G.S. 25-9-324; or

(2) Arose solely under G.S. 25-2-711(3) or G.S. 25-2A-508(5). (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **"Double Debtor" Problem.** This section addresses the "double debtor" problem, which arises when a debtor acquires property that is subject to a security interest created by another debtor.

3. **Taking Subject to Perfected Security Interest.** Consider the following scenario:

Example 1: A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See sections 9-201 and 9-315(a)(1)(A). Under this section, if B creates a security interest in the equipment in favor of SP-B, SP-B's security interest is subordinate to SP-A's security interest, even if SP-B filed against B before SP-A filed against A, and even if SP-B took a purchase-money security interest. Normally, SP-B could have investigated the source of the equipment and discovered SP-A's filing before making an advance against the equipment, whereas SP-A had no reason to search the filings against someone other than its debtor, A.

4. **Taking Subject to Unperfected Security Interest.** This section applies only if the security interest in the transferred collateral was perfected when the transferee acquired the collateral. See subsection (a)(2). If this condition is not met, then the normal priority rules apply.

Example 2: A owns an item of equipment subject to an unperfected security interest in favor of SP-A. A sells the equipment to B, who gives value and takes delivery of the equipment without knowledge of the security interest. B takes free of the security interest. See section 9-317(b). If B then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment.

Example 3: The facts are as in Example 2, except that B knows of SP-A's security interest and therefore takes the equipment subject to it. If B creates a security interest in the equipment in favor of SP-B, this section does not determine the relative priority of the security interests. Rather, the normal priority rules govern. If SP-B perfects its security interest, then, under section 9-322(a)(2), SP-A's unperfected security interest will be junior to SP-B's perfected security interest. The award of priority to SP-B is premised on the belief that SP-A's failure to file could have misled SP-B.

5. **Taking Subject to Perfected Security Interest that Becomes Unperfected.** This section applies only if the security interest in the transferred collateral did not become unperfected at any time after the transferee acquired the collateral. See subsection (a)(3). If this condition is not met, then the normal priority rules apply.

Example 4: As in Example 1, A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See sections 9-201 and 9-315(a)(1)(A). B creates a security interest in favor of SP-B, and SP-B perfects its security interest. This section provides that SP-A's security interest is senior to SP-B's. However, if SP-A's financing statement lapses while SP-B's security interest is perfected, then the normal priority rules would apply, and SP-B's security interest would become senior to SP-A's security interest. See sections 9-322(a)(2) and 9-515(c).

6. **Unusual Situations.** The appropriateness of the rule of subsection (a) is most apparent when it works to subordinate security interests having priority under the basic priority rules of section 9-322(a) or the purchase-money priority rules of section 9-324. The rule also works properly when applied to the security interest of a buyer under section 2-711(3) or a lessee under section 2A-508(5). However, subsection (a) may provide an inappropriate resolution of the "double debtor" problem in some of the wide variety of other contexts in which the problem may arise. Although subsection (b) limits the application of subsection (a) to those cases in which subordination is known to be appropriate, courts should apply the rule in other settings, if necessary to promote the underlying purposes and policies of the Uniform Commercial Code. See section 1-102(1).

§ 25-9-326. Priority of security interests created by new debtor.

(a) Subordination of security interest created by new debtor. — Subject to subsection (b) of this section, a security interest created by a new debtor which is perfected by a filed financing statement that is effective solely under G.S. 25-9-508 in collateral in which a new debtor has or acquires rights is subordinate to a security interest in the same collateral which is perfected other than by a filed financing statement that is effective solely under G.S. 25-9-508.

(b) Priority under other provisions; multiple original debtors. — The other provisions of this Part determine the priority among conflicting security interests in the same collateral perfected by filed financing statements that are effective solely under G.S. 25-9-508. However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Subordination of Security Interests Created by New Debtor.** This section addresses the priority contests that may arise when a new debtor becomes bound by the security agreement of an original debtor and each debtor has a secured creditor.

Subsection (a) subordinates the original debtor's secured party's security interest perfected against the new debtor solely under section 9-508. The security interest is subordinated to security interests in the same collateral perfected by another method, e.g., by filing against the new debtor. As used in this section, "a filed financing statement that is effective solely under section 9-508" refers to a financing statement filed against the original debtor that continues to be effective under section 9-508. It does not encompass a new initial financing statement providing the name of the new debtor, even if the initial financing statement is filed to maintain the effectiveness of a financing statement under the circumstances described in section 9-508(b). Nor does it encompass a financing statement filed against the original debtor which remains effective against collateral transferred by the original debtor to the new debtor. See section 9-508(c). Concerning priority contests involving transferred collateral, see sections 9-325 and 9-507.

Example 1: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-possession security interest in an item of Z Corp's inventory. Z Corp becomes bound as debtor by X Corp's security agreement (e.g., Z Corp buys X Corp's assets and assumes its security agreement). See section 9-203(d). Under section 9-508, SP-X's financing statement is effective to perfect a security interest in the item of inventory in which Z Corp has rights. However, subsection (a) provides that SP-X's security interest is subordinate to SP-Z's, regardless of whether SP-X's financing statement was filed before SP-Z perfected its security interest.

Example 2: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-filing security interest in Z Corp's existing and after-acquired inventory. Z Corp becomes bound as debtor by X Corp's security agreement. Subsequently, Z Corp acquires a new item of inventory. Under section 9-508, SP-X's financing statement is effective to perfect a security interest in the new item of inventory in which Z Corp has rights. However, because SP-Z's security interest was perfected by another method, subsection (a) provides that SP-X's security interest is subordinate to SP-Z's, regardless of which financing statement was filed first. This would be the case even if SP-Z filed after Z Corp became bound by X Corp's security agreement.

3. **Other Priority Rules.** Subsection (b) addresses the priority among security interests created by the original debtor (X Corp). By invoking the other priority rules of this subpart, as applicable, subsection (b) preserves the relative priority of security interests created by the original debtor.

Example 3: Under the facts of Example 2, SP-Y also holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory. SP-Y filed after SP-X. Inasmuch as both SP-X's and SP-Y's security interests in inventory acquired by Z Corp after it became bound are perfected solely under section 9-508, the normal priority rules determine their relative priorities. Under the "first-to-file-or-perfect" rule of section 9-322(a)(1), SP-X has priority over SP-Y.

Example 4: Under the facts of Example 3, after Z Corp became bound by X Corp's security agreement, SP-Y promptly filed a new initial financing statement against Z Corp. At that time, SP-X's security interest was perfected only by virtue of its original filing against X Corp which was "effective solely under section 9-508." Because SP-Y's security interest no longer is perfected by a financing statement that is "effective solely under section 9-508," this section does not apply to the priority contest. Rather, the normal priority rules apply. Under section 9-322, because SP-Y's financing statement was filed against Z Corp, the new debtor, before SP-X's, SP-Y's security interest is senior to that of SP-X. Similarly, the normal priority rules would govern priority between SP-Y and SP-Z.

The second sentence of subsection (b) effectively limits the applicability of the first sentence to situations in which a new debtor has become bound by more than one security agreement entered into by the same original debtor. When the new debtor has become bound by security agreements entered into by different original debtors, the second sentence provides that priority is based on priority in time of the new debtor's becoming bound.

Example 5: Under the facts of Example 2, SP-W holds a perfected-by-filing security interest in W Corp's existing and after-acquired inventory. After Z Corp became bound by X Corp's security agreement in favor of SP-X, Z Corp became bound by W Corp's security agreement. Under subsection (b), SP-W's security interest in inventory acquired by Z Corp is subordinate to that of SP-X, because Z Corp became bound under SP-X's security agreement before it became bound under SP-W's security agreement. This is the result regardless of which financing statement (SP-X's or SP-W's) was filed first.

The second sentence of subsection (b) reflects the generally accepted view that priority based on the first-to-file rule is inappropriate for resolving priority disputes when the filings were made against different debtors. Like subsection (a) and the first sentence of subsection (b), however, the second sentence of subsection (b) relates only to priority conflicts among security interests perfected by filed financing statements that are "effective solely under section 9-508."

Example 6: Under the facts of Example 5, after Z Corp became bound by W Corp's security agreement, SP-W promptly filed a new initial financing statement against Z Corp. At that time, SP-X's security interest was perfected only pursuant to its original filing against X Corp which was "effective solely under section 9-508." Because SP-W's security interest is not perfected by a financing statement that is "effective solely under section 9-508," this section does not apply to the priority contest. Rather, the normal priority rules apply. Under section 9-322, because SP-W's financing statement was the first to be filed against Z Corp, the new debtor, SP-W's security interest is senior to that of SP-X. Similarly, the normal priority rules would govern priority between SP-W and SP-Z.

§ 25-9-327. Priority of security interests in deposit account.

The following rules govern priority among conflicting security interests in the same deposit account:

(1) A security interest held by a secured party having control of the deposit account under G.S. 25-9-104 has priority over a conflicting security interest held by a secured party that does not have control.
(2) Except as otherwise provided in subdivisions (3) and (4) of this section, security interests perfected by control under G.S. 25-9-314 rank according to priority in time of obtaining control.
(3) Except as otherwise provided in subdivision (4) of this section, a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.
(4) A security interest perfected by control under G.S. 25-9-104(a)(3) has priority over a security interest held by the bank with which the deposit account is maintained. (1997-181, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; derived from former section 9-115(5).

2. **Scope of This Section.** This section contains the rules governing the priority of conflicting security interests in deposit accounts. It overrides conflicting priority rules. See sections 9-322(f)(1) and 9-324(a), (b), (d), and (f). This section does not apply to accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not "deposit accounts."

3. **Control.** Under paragraph (1), security interests perfected by control (sections 9-104 and 9-314) take priority over those perfected otherwise, e.g., as identifiable cash proceeds under section 9-315. Secured parties for whom the deposit account is an integral part of the credit decision will, at a minimum, insist upon the right to immediate access to the deposit account upon the debtor's default (i.e., control). Those secured parties for whom the deposit account is less essential will not take control, thereby running the risk that the debtor will dispose of funds on deposit (either outright or for collateral purposes) after default but before the account can be frozen by court order or the secured party can obtain control.

Paragraph (2) governs the case (expected to be very rare) in which a bank enters into a section 9-104(a)(2) control agreement with more than one secured party. It provides that the security interests rank according to time of obtaining control. If the bank is solvent and the control agreements are well drafted, the bank will be liable to each secured party, and the priority rule will have no practical effect.

4. **Priority of Bank.** Under paragraph (3), the security interest of the bank with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit account, regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.

A secured party who takes a security interest in the deposit account as original collateral can protect itself against the results of this rule in one of two ways. It can take control of the deposit account by becoming the bank's customer. Under paragraph (4), this arrangement operates to subordinate the bank's security interest. Alternatively, the secured party can obtain a subordination agreement from the bank. See section 9-339.

A secured party who claims the deposit account as proceeds of other collateral can reduce the risk of becoming junior by obtaining the debtor's agreement to deposit proceeds into a specific cash-collateral account and obtaining the agreement of that bank to subordinate all its claims to those of the secured party. But if the debtor violates its agreement and deposits funds into a deposit account other than the cash-collateral account, the secured party risks being subordinated.

5. **Priority in Proceeds of, and Funds Transferred from, Deposit Account.** The priority afforded by this section does not extend to proceeds of a deposit account. Rather, section 9-322(c) through (e) and the provisions referred to in section 9-322(f) govern priorities in proceeds of a deposit account. Section 9-315(d) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see section 9-332.

§ 25-9-328. Priority of security interests in investment property.

The following rules govern priority among conflicting security interests in the same investment property:

(1) A security interest held by a secured party having control of investment property under G.S. 25-9-106 has priority over a security interest held by a secured party that does not have control of the investment property.

(2) Except as otherwise provided in subdivisions (3) and (4) of this section, conflicting security interests held by secured parties each of which has control under G.S. 25-9-106 rank according to priority in time of:

  a. If the collateral is a security, obtaining control;

  b. If the collateral is a security entitlement carried in a securities account and:

    1. If the secured party obtained control under G.S. 25-8-106(d)(1), the secured party's becoming the person for which the securities account is maintained;

    2. If the secured party obtained control under G.S. 25-8-106(d)(2), the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account; or

    3. If the secured party obtained control through another person under G.S. 25-8-106(d)(3), the time on which priority would be based under this subdivision if the other person were the secured party; or

  c. If the collateral is a commodity contract carried with a commodity intermediary, the satisfaction of the requirement for control specified in G.S. 25-9-106(b)(2) with respect to commodity contracts carried or to be carried with the commodity intermediary.

(3) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

(4) A security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party.

(5) A security interest in a certificated security in registered form which is perfected by taking delivery under G.S. 25-9-313(a) and not by control under G.S. 25-9-314 has priority over a conflicting security interest perfected by a method other than control.

(6) Conflicting security interests created by a broker, securities intermediary, or commodity intermediary which are perfected without control under G.S. 25-9-106 rank equally.

(7) In all other cases, priority among conflicting security interests in investment property is governed by G.S. 25-9-322 and G.S. 25-9-323. (1997-181, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-115(5).

2. **Scope of This Section.** This section contains the rules governing the priority of conflicting security interests in investment property. Paragraph (1) states the most important general rule—that a secured party who obtains control has priority over a secured party who does not obtain control. Paragraphs (2) through (4) deal with conflicting security interests each of which is perfected by control. Paragraph (5)

addresses the priority of a security interest in a certificated security which is perfected by delivery but not control. Paragraph (6) deals with the relatively unusual circumstance in which a broker, securities intermediary, or commodity intermediary has created conflicting security interests none of which is perfected by control. Paragraph (7) provides that the general priority rules of sections 9-322 and 9-323 apply to cases not covered by the specific rules in this section. The principal application of this residual rule is that the usual first in time of filing rule applies to conflicting security interests that are perfected only by filing. Because the control priority rule of paragraph (1) provides for the ordinary cases in which persons purchase securities on margin credit from their brokers, there is no need for special rules for purchase-money security interests. See also section 9-103 (limiting purchase-money collateral to goods and software).

3. **General Rule: Priority of Security Interest Perfected by Control.** Under paragraph (1), a secured party who obtains control has priority over a secured party who does not obtain control. The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by filing. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of section 9-309(10), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of paragraph (1) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting security interests only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by filing without regard to inquiry into whether the control secured party was aware of the filed security interest. Prior to the 1994 revisions to articles 8 and 9, article 9 did not permit perfection of security interests in securities by filing. Accordingly, parties who deal in securities never developed a practice of searching the UCC files before conducting securities transactions. Although filing is now a permissible method of perfection, in order to avoid disruption of existing practices in this business it is necessary to give perfection by filing a different and more limited effect for securities than for some other forms of collateral. The priority rules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the files. Quite the contrary, the control priority rule is intended to ensure that, with respect to investment property, secured parties who do obtain control are entirely unaffected by filings. To state the point another way, perfection by filing is intended to affect only general creditors or other secured creditors who rely on filing. The rule that a security interest perfected by filing can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where filing is not given the same effect as for some other forms of property. No implication is made about the effect of filing with respect to security interests in other forms of property, nor about other article 9 rules, e.g., section 9-330, which govern the circumstances in which security interests in other forms of property perfected by filing can be primed by subsequent perfected security interests.

The following examples illustrate the application of the priority rule in paragraph (1):

Example 1: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock for which Debtor has a certificate. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor delivers the certificate, properly indorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see section 8-106(b)(1), and hence has priority over Alpha.

Example 2: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor instructs Able to have the 1000 shares transferred through the clearing corporation to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see section 8-106(d)(1), and hence has priority over Alpha.

Example 3: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, which is held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. stock (more precisely, in the Debtor's security entitlement to the financial asset consisting of the XYZ Co. stock). Beta has control, see section 8-106(d)(2), and hence has priority over Alpha.

Example 4: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of section 8-106(e) that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of paragraph (1).

4. **Conflicting Security Interests Perfected by Control: Priority of Securities Intermediary or Commodity Intermediary.** Paragraphs (2) through (4) govern the priority of conflicting security interests each of which is perfected by control. The following example explains the application of the rules in paragraphs (3) and (4):

Example 5: Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. stock carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of paragraph (1) does not apply. Compare Example 4. Paragraph (3) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an external lender, so Able has priority over Beta. (Paragraph (4) contains a parallel rule for commodity intermediaries.) The agreement among Able, Beta, and Debtor could, of course, determine the relative priority of the security interests of Able and Beta, see section 9-339, but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

5. **Conflicting Security Interests Perfected by Control: Temporal Priority.** Former section 9-115 introduced into article 9 the concept of conflicting security interests that rank equally. Paragraph (2) of this section governs priority in those circumstances in which more than one secured party (other than a broker, securities intermediary, or commodity intermediary) has control. It replaces the equal-priority rule for conflicting security interests in investment property with a temporal rule. For securities, both certificated and uncertificated, under paragraph (2)(A) priority is based on the time that control is obtained. For security entitlements carried in securities accounts, the treatment is more complex. Paragraph (2)(B) bases priority on the timing of the steps taken to achieve control. The following example illustrates the application of paragraph (2).

Example 6: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through a securities account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha will also have the right to direct dispositions and receive the proceeds. Later, Debtor borrows from Beta and grants Beta a security interest in all its investment property, existing and after-acquired. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected-by-control security interests in the security entitlement to the XYZ Co. stock by virtue of their agreements with Able. See sections 8-106(d)(2), 9-106(a), and 9-314(a). Under paragraph (2)(B)(ii), the priority of each security interest dates from the time of the secured party's agreement with Able. Because Alpha's agreement was first in time, Alpha has priority. This priority applies equally to security entitlements to financial assets credited to the account after the agreement was entered into.

The priority rule is analogous to "first-to-file" priority under section 9-322 with respect to after-acquired collateral. Paragraphs (2)(B)(i) and (2)(B)(iii) provide similar rules for security entitlements as to which control is obtained by other methods, and paragraph (2)(C) provides a similar rule for commodity contracts carried in a commodity account. Section 8-510 also has been revised to provide a temporal priority conforming to paragraph (2)(B).

6. **Certificated Securities.** A long-standing practice has developed whereby secured parties whose collateral consists of a security evidenced by a security certificate take possession of the security certificate. If the security certificate is in bearer form, the secured party's acquisition of possession constitutes "delivery" under section 8-301(a)(1), and the delivery constitutes "control" under section 8-106(a). Comment 5 discusses the priority of security interests perfected by control of investment property.

If the security certificate is in registered form, the secured party will not achieve control over the security unless the security certificate contains an appropriate indorsement or is (re-)registered in the secured party's name. See section 8-106(b). However, the secured party's acquisition of possession constitutes "delivery" of the security certificate under section 8-301 and serves to perfect the security interest under section 9-313(a), even if the security certificate has not been appropriately indorsed and has not been (re)registered in the secured party's name. A security interest perfected by this method has priority over a security interest perfected other than by control (e.g., by filing). See paragraph (5).

The priority rule stated in paragraph (5) may seem anomalous, in that it can afford less favorable treatment to purchasers who buy collateral outright than to those who take a security interest in it. For example, a buyer of a security certificate would cut off a security interest perfected by filing only if the buyer achieves the status of a protected purchaser under section 8-303. The buyer would not be a protected purchaser, for example, if it does not obtain "control" under section 8-106 (e.g., if it fails to obtain a proper indorsement of the certificate) or if it had notice of an adverse claim under section 8-105. The apparent anomaly disappears, however, when one understands the priority rule not as one intended to protect careless or guilty parties, but as one that eliminates the need to conduct a search of the public records only insofar as necessary to serve the needs of the securities markets.

7. **Secured Financing of Securities Firms.** Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control-beats-non-control priority rule of paragraph (1), as supplemented by the special rules set out in paragraphs (2) (temporal priority— first to control), (3) (special priority for securities intermediary), and (6) (equal priority for noncontrol). The following examples illustrate the priority rules as applied to this setting. (In all cases it is assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between a secured lender and the firm's own customers are governed by section 8-511.)

Example 7: Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic-perfection rule of section 9-309(10). Neither Alpha nor Beta has control. Paragraph (6) provides that the security interests of Alpha and Beta rank equally, because each of them has a noncontrol security interest granted by a securities firm. They share pro-rata.

Example 8: Able enters into financing arrangements, with Alpha Bank and Beta Bank as in Example 7. At some point, however, Beta decides that it is unwilling to continue to provide financing on a noncontrol basis. Able directs the clearing corporation where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic-perfection rule of section 9-309(10), and Beta under that rule and also the perfection-by-control rule in section

9-314(a). Beta has control but Alpha does not. Beta has priority over Alpha under paragraph (1).

Example 9: Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. Paragraph (2) awards priority to whichever secured party first entered into the agreement with Clearing Corporation.

8. **Relation to Other Law.** Section 1-103 provides that "unless displaced by particular provisions of the Uniform Commercial Code, the principles of law and equity . . . shall supplement its provisions." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a secured party from asserting its article 9 priority depends on an assessment of the secured party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the UCC.

Some circumstances in which other law is clearly displaced by the UCC rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a person with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, article 8 provides protections against adverse claims to certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under section 9-328, but also qualifies for protection against adverse claims under section 8-303, 8-502, or 8-510, resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the 1994 revision of article 8 and the provisions of article 9 governing investment property was to ensure that secured financing transactions can be implemented on a simple, timely, and certain basis. One of the circumstances that led to the revision was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an inquiry into the state of a secured party's awareness of potential conflicting claims because a rule under which a person's rights depended on that sort of after-the-fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rules of this section would have incorporated that test. The fact that they do not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

§ 25-9-329. Priority of security interests in letter-of-credit right.

The following rules govern priority among conflicting security interests in the same letter-of-credit right:

(1) A security interest held by a secured party having control of the letter-of-credit right under G.S. 25-9-107 has priority to the extent of its control over a conflicting security interest held by a secured party that does not have control.

(2) Security interests perfected by control under G.S. 25-9-314 rank according to priority in time of obtaining control. (1997-181, s. 5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; loosely modeled after former section 9-115(5).

2. **General Rule.** Paragraph (1) awards priority to a secured party who perfects a security interest directly in letter-of-credit rights (i.e., one that takes an assignment of proceeds and obtains consent of the issuer or any nominated person under section 5-114(c)) over another conflicting security interest (i.e., one that is perfected automatically in the letter-of-credit rights as supporting obligations under section 9-308(d)). This is consistent with international letter-of-credit practice and provides finality to payments made to recognized assignees of letter-of-credit proceeds. If an issuer or nominated person recognizes multiple security interests in a letter-of-credit right, resulting in multiple parties having control (section 9-107), under paragraph (2) the security interests rank according to the time of obtaining control.

3. **Drawing Rights; Transferee Beneficiaries.** Drawing under a letter of credit is personal to the beneficiary and requires the beneficiary to perform the conditions for drawing under the letter of credit. Accordingly, a beneficiary's grant of a security interest in a letter of credit includes the beneficiary's "letter-of-credit right" as defined in section 9-102 and the right to "proceeds of (the) letter of credit" as defined in section 5-114(a), but does not include the right to demand payment under the letter of credit.

Section 5-114(e) provides that the "(r)ights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds." To the extent the rights of a transferee beneficiary or nominated person are independent and superior, this article does not apply. See section 9-109(c).

Under article 5, there is in effect a novation upon the transfer with the issuer becoming bound on a new, independent obligation to the transferee. The rights of nominated persons and transferee beneficiaries under a letter of credit include the right to demand payment from the issuer. Under section 5-114(e), their rights to payment are independent of their obligations to the beneficiary (or original beneficiary) and superior to the rights of assignees of letter-of-credit proceeds (section 5-114(c)) and others claiming a security interest in the beneficiary's (or original beneficiary's) letter-of-credit rights.

A transfer of drawing rights under a transferable letter of credit establishes independent article 5 rights in the transferee and does not create or perfect an article 9 security interest in the transferred drawing rights. The definition of "letter-of-credit right" in section 9-102 excludes a beneficiary's drawing rights. The exercise of drawing rights by a transferee beneficiary may breach a contractual obligation of the transferee to the original beneficiary concerning when and how much the transferee may draw or how it may use the funds received under the letter of credit. If, for example, drawing rights are transferred to support a sale or loan from the transferee to the original beneficiary, then the transferee would be obligated to the original beneficiary under the sale or loan agreement to account for any drawing and for the use of any funds received. The transferee's obligation would be governed by the applicable law of contracts or restitution.

4. **Secured Party-Transferee Beneficiaries.** As described in comment 3, drawing rights under letters of credit are transferred in many commercial contexts in which the transferee is not a secured party claiming a security interest in an underlying receivable supported by the letter of credit. Consequently, a transfer of a letter of credit is not a method of "perfection" of a security interest. The transferee's independent right to draw under the letter of credit and to receive and retain the value thereunder (in effect, priority) is not based on article 9 but on letter-of-credit law and the terms of the letter of credit. Assume, however, that a secured party does hold a security interest in a receivable that is owned by a beneficia-

ry-debtor and supported by a transferable letter of credit. Assume further that the beneficiary-debtor causes the letter of credit to be transferred to the secured party, the secured party draws under the letter of credit, and, upon the issuer's payment to the secured party-transferee, the underlying account debtor's obligation to the original beneficiary-debtor is satisfied. In this situation, the payment to the secured party-transferee is proceeds of the receivable collected by the secured party-transferee. Consequently, the secured party-transferee would have certain duties to the debtor and third parties under article 9. For example, it would be obliged to collect under the letter of credit in a commercially reasonable manner and to remit any surplus pursuant to sections 9-607 and 9-608.

This scenario is problematic under letter-of-credit law and practice, inasmuch as a transferee beneficiary collects in its own right arising from its own performance. Accordingly, under section 5-114, the independent and superior rights of a transferee control over any inconsistent duties under article 9. A transferee beneficiary may take a transfer of drawing rights to avoid reliance on the original beneficiary's credit and collateral, and it may consider any article 9 rights superseded by its article 5 rights. Moreover, it will not always be clear (i) whether a transferee beneficiary has a security interest in the underlying collateral, (ii) whether any security interest is senior to the rights of others, or (iii) whether the transferee beneficiary is aware that it holds a security interest. There will be clear cases in which the role of a transferee beneficiary as such is merely incidental to a conventional secured financing. There also will be cases in which the existence of a security interest may have little to do with the position of a transferee beneficiary as such. In dealing with these cases and less clear cases involving the possible application of article 9 to a nominated person or a transferee beneficiary, the right to demand payment under a letter of credit should be distinguished from letter-of-credit rights. The courts also should give appropriate consideration to the policies and provisions of article 5 and letter-of-credit practice as well as article 9.

§ 25-9-330. Priority of purchaser of chattel paper or instrument.

(a) Purchaser's priority: security interest claimed merely as proceeds. — A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

(1) In good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under G.S. 25-9-105; and

(2) The chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(b) Purchaser's priority: other security interests. — A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under G.S. 25-9-105 in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

(c) Chattel paper purchaser's priority in proceeds. — Except as otherwise provided in G.S. 25-9-327, a purchaser having priority in chattel paper under subsection (a) or (b) of this section also has priority in proceeds of the chattel paper to the extent that:

(1) G.S. 25-9-322 provides for priority in the proceeds; or

(2) The proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.

(d) Instrument purchaser's priority. — Except as otherwise provided in G.S. 25-9-331(a), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

(e) Holder of purchase-money security interest gives new value. — For purposes of subsections (a) and (b) of this section, the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

(f) Indication of assignment gives knowledge. — For purposes of subsections (b) and (d) of this section, if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-308.

2. **Nontemporal Priority.** This article permits a security interest in chattel paper or instruments to be perfected either by filing or by the secured party's taking possession. This section enables secured parties and other purchasers of chattel paper (both electronic and tangible) and instruments to obtain priority over earlier-perfected security interests.

3. **Chattel Paper.** Subsections (a) and (b) follow former section 9-308 in distinguishing between earlier-perfected security interests in chattel paper that is claimed merely as proceeds of inventory subject to a security interest and chattel paper that is claimed other than merely as proceeds. Like former section 9-308, this section does not elaborate upon the phrase "merely as proceeds." For an elaboration, see PEB Commentary No. 8.

This section makes explicit the "good faith" requirement and retains the requirements of "the ordinary course of the purchaser's business" and the giving of "new value" as conditions for priority. Concerning the last, this article deletes former section 9-108 and adds to section 9-102 a completely different definition of the term "new value." Under subsection (e), the holder of a purchase-money security interest in inventory is deemed to give "new value" for chattel paper constituting the proceeds of the inventory. Accordingly, the purchase-money secured party may qualify for priority in the chattel paper under subsection (a) or (b), whichever is applicable, even if it does not make an additional advance against the chattel paper.

If a possessory security interest in tangible chattel paper or a perfected-by-control security interest in electronic chattel paper does not qualify for priority under this section, it may be subordinate to a perfected-by-filing security interest under section 9-322(a)(1).

4. **Possession.** The priority afforded by this section turns in part on whether a purchaser "takes possession" of tangible chattel paper. Similarly, the governing law provisions in section 9-301 address both "possessory" and "nonpossessory" security interests. Two common practices have raised particular concerns. First, in some cases the parties create more than one copy or counterpart of chattel paper evidencing a single secured obligation or lease. This practice raises questions as to which counterpart is the "original" and whether it is necessary for a purchaser to take possession of all counterparts in order to "take possession" of the chattel paper. Second, parties sometimes enter into a single "master" agreement. The master agreement contemplates that the parties will enter into separate "schedules" from time to time, each evidencing chattel paper. Must a purchaser of an obligation or lease evidenced by a single schedule also take possession of the master agreement as well as the schedule in order to "take possession" of the chattel paper?

The problem raised by the first practice is easily solved. The parties may in the terms of their agreement and by designation on the chattel paper identify only one counterpart as the original chattel paper for purposes of taking possession of the chattel paper. Concerns about the second practice also are easily solved by careful drafting. Each schedule should provide that it incorporates the terms of the master agreement, not the other way around. This will make it clear that each schedule is a "stand alone" document.

5. **Chattel Paper Claimed Merely as Proceeds.** Subsection (a) revises the rule in former section 9-308(b) to eliminate reference to what the purchaser knows. Instead, a purchaser who meets the possession or control, ordinary course, and new value requirements takes priority over a competing security interest unless the chattel paper itself indicates that it has been assigned to an identified assignee other than the purchaser. Thus subsection (a) recognizes the common practice of placing a "legend" on chattel paper to indicate that it has been assigned. This approach, under which the chattel paper purchaser who gives new value in ordinary course can rely on possession of unlegended, tangible chattel paper without any concern for other facts that it may know, comports with the expectations of both inventory and chattel paper financers.

6. **Chattel Paper Claimed Other Than**

Merely as Proceeds. Subsection (b) eliminates the requirement that the purchaser take without knowledge that the "specific paper" is subject to the security interest and substitutes for it the requirement that the purchaser take "without knowledge that the purchase violates the rights of the secured party." This standard derives from the definition of "buyer in ordinary course of business" in section 1-201(9). The source of the purchaser's knowledge is irrelevant. Note, however, that "knowledge" means "actual knowledge." Section 1-201(25).

In contrast to a junior secured party in accounts, who may be required in some special circumstances to undertake a search under the "good faith" requirement, see comment 5 to section 9-331, a purchaser of chattel paper under this section is not required as a matter of good faith to make a search in order to determine the existence of prior security interests. There may be circumstances where the purchaser undertakes a search nevertheless, either on its own volition or because other considerations make it advisable to do so, e.g., where the purchaser also is purchasing accounts. Without more, a purchaser of chattel paper who has seen a financing statement covering the chattel paper or who knows that the chattel paper is encumbered with a security interest, does not have knowledge that its purchase violates the secured party's rights. However, if a purchaser sees a statement in a financing statement to the effect that a purchase of chattel paper from the debtor would violate the rights of the filed secured party, the purchaser would have such knowledge. Likewise, under new subsection (f), if the chattel paper itself indicates that it had been assigned to an identified secured party other than the purchaser, the purchaser would have wrongful knowledge for purposes of subsection (b), thereby preventing the purchaser from qualifying for priority under that subsection, even if the purchaser did not have actual knowledge. In the case of tangible chattel paper, the indication normally would consist of a written legend on the chattel paper. In the case of electronic chattel paper, this article leaves to developing market and technological practices the manner in which the chattel paper would indicate an assignment.

7. **Instruments.** Subsection (d) contains a special priority rule for instruments. Under this subsection, a purchaser of an instrument has priority over a security interest perfected by a method other than possession (e.g., by filing, temporarily under section 9-312(e) or (g), as proceeds under section 9-315(d), or automatically upon attachment under section 9-309(4) if the security interest arises out of a sale of the instrument) if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party. Generally, to the extent subsection (d) conflicts with section 3-306, subsection (d) governs. See section 3-102(b). For example, notice of a conflicting security interest precludes a purchaser from becoming a holder in due course under section 3-302 and thereby taking free of all claims to the instrument under section 3-306. However, a purchaser who takes even with knowledge of the security interest qualifies for priority under subsection (d) if it takes without knowledge that the purchase violates the rights of the holder of the security interest. Likewise, a purchaser qualifies for priority under subsection (d) if it takes for "value" as defined in section 1-201, even if it does not take for "value" as defined in section 3-303.

Subsection (d) is subject to section 9-331(a), which provides that article 9 does not limit the rights of a holder in due course under article 3. Thus, in the rare case in which the purchaser of an instrument qualifies for priority under subsection (d), but another person has the rights of a holder in due course of the instrument, the other person takes free of the purchaser's claim. See section 3-306.

The rule in subsection (d) is similar to the rules in subsections (a) and (b), which govern priority in chattel paper. The observations in comment 6 concerning the requirement of good faith and the phrase "without knowledge that the purchase violates the rights of the secured party" apply equally to purchasers of instruments. However, unlike a purchaser of chattel paper, to qualify for priority under this section a purchaser of an instrument need only give "value" as defined in section 1-201; it need not give "new value." Also, the purchaser need not purchase the instrument in the ordinary course of its business.

Subsection (d) applies to checks as well as notes. For example, to collect and retain checks that are proceeds (collections) of accounts free of a senior secured party's claim to the same checks, a junior secured party must satisfy the good-faith requirement (honesty in fact and the observance of reasonable commercial standards of fair dealing) of this subsection. This is the same good-faith requirement applicable to holders in due course. See section 9-331, comment 5.

8. **Priority in Proceeds of Chattel Paper.** Subsection (c) sets forth the two circumstances under which the priority afforded to a purchaser of chattel paper under subsection (a) or (b) extends also to proceeds of the chattel paper. The first is if the purchaser would have priority under the normal priority rules applicable to proceeds. The second, which the following comments discuss in greater detail, is if the proceeds consist of the specific goods covered by the chattel paper. Former article 9 generally was silent as to the priority of a security inter-

est in proceeds when a purchaser qualifies for priority under section 9-308 (but see former section 9-306(5)(b), concerning returned and repossessed goods).

9. **Priority in Returned and Repossessed Goods.** Returned and repossessed goods may constitute proceeds of chattel paper. The following comments explain the treatment of returned and repossessed goods as proceeds of chattel paper. The analysis is consistent with that of PEB Commentary No. 5, which these comments replace, and is based upon the following example:

Example: SP-1 has a security interest in all the inventory of a dealer in goods (Dealer); SP-1's security interest is perfected by filing. Dealer sells some of its inventory to a buyer in the ordinary course of business (BIOCOB) pursuant to a conditional sales contract (chattel paper) that does not indicate that it has been assigned to SP-1. SP-2 purchases the chattel paper from Dealer and takes possession of the paper in good faith, in the ordinary course of business, and without knowledge that the purchase violates the rights of SP-1. Subsequently, BIOCOB returns the goods to Dealer because they are defective. Alternatively, Dealer acquires possession of the goods following BIOCOB's default.

10. **Assignment of Nonlease Chattel Paper.**

a. **Loan by SP-2 to Dealer Secured by Chattel Paper (or Functional Equivalent Pursuant to Recourse Arrangement).**

(1) **Returned Goods.** If BIOCOB returns the goods to Dealer for repairs, Dealer is merely a bailee and acquires thereby no meaningful rights in the goods to which SP-1's security interest could attach. (Although SP-1's security interest could attach to Dealer's interest as a bailee, that interest is not likely to be of any particular value to SP-1.) Dealer is the owner of the chattel paper (i.e., the owner of a right to payment secured by a security interest in the goods); SP-2 has a security interest in the chattel paper, as does SP-1 (as proceeds of the goods under section 9-315). Under section 9-330, SP-2's security interest in the chattel paper is senior to that of SP-1. SP-2 enjoys this priority regardless of whether, or when, SP-2 filed a financing statement covering the chattel paper. Because chattel paper and goods represent different types of collateral, Dealer does not have any meaningful interest in goods to which either SP-1's or SP-2's security interest could attach in order to secure Dealer's obligations to either creditor. See section 9-102 (defining "chattel paper" and "goods").

Now assume that BIOCOB returns the goods to Dealer under circumstances whereby Dealer once again becomes the owner of the goods. This would be the case, for example, if the goods were defective and BIOCOB was entitled to reject or revoke acceptance of the goods. See sections 2-602 (rejection), and 2-608 (revocation of acceptance). Unless BIOCOB has waived its defenses as against assignees of the chattel paper, SP-1's and SP-2's rights against BIOCOB would be subject to BIOCOB's claims and defenses. See sections 9-403 and 9-404. SP-1's security interest would attach again because the returned goods would be proceeds of the chattel paper. Dealer's acquisition of the goods easily can be characterized as "proceeds" consisting of an "in kind" collection on or distribution on account of the chattel paper. See section 9-102 (definition of "proceeds"). Assuming that SP-1's security interest is perfected by filing against the goods and that the filing is made in the same office where a filing would be made against the chattel paper, SP-1's security interest in the goods would remain perfected beyond the 20-day period of automatic perfection. See section 9-315(d).

Because Dealer's newly reacquired interest in the goods is proceeds of the chattel paper, SP-2's security interest also would attach in the goods as proceeds. If SP-2 had perfected its security interest in the chattel paper by filing (again, assuming that filing against the chattel paper was made in the same office where a filing would be made against the goods), SP-2's security interest in the reacquired goods would be perfected beyond 20 days. See section 9-315(d). However, if SP-2 had relied only on its possession of the chattel paper for perfection and had not filed against the chattel paper or the goods, SP-2's security interest would be unperfected after the 20-day period. See section 9-315(d). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under section 9-330(c). The result in this priority contest is not affected by SP-2's acquiescence or non-acquiescence in the return of the goods to Dealer.

(2) **Repossessed Goods.** As explained above, Dealer owns the chattel paper covering the goods, subject to security interests in favor of SP-1 and SP-2. In article 9 parlance, Dealer has an interest in chattel paper, not goods. If Dealer, SP-1, or SP-2 repossesses the goods upon BIOCOB's default, whether the repossession is rightful or wrongful as among Dealer, SP-1, or SP-2, Dealer's interest will not change. The location of goods and the party who possesses them does not affect the fact that Dealer's interest is in chattel paper, not goods. The goods continue to be owned by BIOCOB. SP-1's security interest in the goods does not attach until such time as Dealer reacquires an interest (other than a bare possessory interest) in the goods. For example, Dealer might buy the goods at a foreclosure sale from SP-2 (whose security interest in the chattel paper is senior to that of SP-1); that disposition would cut off BIOCOB's rights in the goods. Section 9-617.

In many cases the matter would end upon sale of the goods to Dealer at a foreclosure sale and there would be no priority contest between SP-1 and SP-2; Dealer would be unlikely to buy the goods under circumstances whereby SP-2 would retain its security interest. There can be exceptions, however. For example, Dealer may be obliged to purchase the goods from SP-2 and SP-2 may be obliged to convey the goods to Dealer, but Dealer may fail to pay SP-2. Or, one could imagine that SP-2, like SP-1, has a general security interest in the inventory of Dealer. In the latter case, SP-2 should not receive the benefit of any special priority rule, since its interest in no way derives from priority under section 9-330. In the former case, SP-2's security interest in the goods reacquired by Dealer is senior to SP-1's security interest under section 9-330.

b. **Dealer's Outright Sale of Chattel Paper to SP-2.** Article 9 also applies to a transaction whereby SP-2 buys the chattel paper in an outright sale transaction without recourse against Dealer. Sections 1-201(37) and 9-109(a). Although Dealer does not, in such a transaction, retain any residual ownership interest in the chattel paper, the chattel paper constitutes proceeds of the goods to which SP-1's security interest will attach and continue following the sale of the goods. Section 9-315(a)(1). Even though Dealer has not retained any interest in the chattel paper, as discussed above BIOCOB subsequently may return the goods to Dealer under circumstances whereby Dealer reacquires an interest in the goods. The priority contest between SP-1 and SP-2 will be resolved as discussed above; section 9-330 makes no distinction among purchasers of chattel paper on the basis of whether the purchaser is an outright buyer of chattel paper or one whose security interest secures an obligation of Dealer.

11. **Assignment of Lease Chattel Paper.** As defined in section 9-102, "chattel paper" includes not only writings that evidence security interests in specific goods but also those that evidence true leases of goods.

The analysis with respect to lease chattel paper is similar to that set forth above with respect to nonlease chattel paper. It is complicated, however, by the fact that, unlike the case of chattel paper arising out of a sale, Dealer retains a residual interest in the goods. See section 2A-103(1)(q) (defining "lessor's residual interest"); In re Leasing Consultants, Inc., 486 F.2d 367 (2d Cir. 1973) (lessor's residual interest under true lease is an interest in goods and is a separate type of collateral from lessor's interest in the lease). If Dealer leases goods to a "lessee in ordinary course of business" (LIOCOB), then LIOCOB takes its interest under the lease (i.e., its "leasehold interest") free of the security interest of SP-1. See section 2A-103(1)(m) (defining "leasehold interest") and (1)(o) (defining "lessee in ordinary course of business") and section 2A-307(3). SP-1 would, however, retain its security interest in the residual interest. In addition, SP-1 would acquire an interest in the lease chattel paper as proceeds. If Dealer then assigns the lease chattel paper to SP-2, section 9-330 gives SP-2 priority over SP-1 with respect to the chattel paper, but not with respect to the residual interest in the goods. Consequently, assignees of lease chattel paper typically take a security interest in and file against the lessor's residual interest in goods, expecting their priority in the goods to be governed by the first-to-file-or-perfect rule of section 9-322.

If the goods are returned to Dealer, other than upon expiration of the lease term, then the security interests of both SP-1 and SP-2 normally would attach to the goods as proceeds of the chattel paper. (If the goods are returned to Dealer at the expiration of the lease term and the lessee has made all payments due under the lease, however, then Dealer no longer has any rights under the chattel paper. Dealer's interest in the goods consists solely of its residual interest, as to which SP-2 has no claim.) This would be the case, for example, when the lessee rescinds the lease or when the lessor recovers possession in the exercise of its remedies under article 2A. See, e.g., section 2A-525. If SP-2 enjoyed priority in the chattel paper under section 9-330, then SP-2 likewise would enjoy priority in the returned goods as proceeds. This does not mean that SP-2 necessarily is entitled to the entire value of the returned goods. The value of the goods represents the sum of the present value of (i) the value of their use for the term of the lease and (ii) the value of the residual interest. SP-2 has priority in the former, but SP-1 ordinarily would have priority in the latter. Thus, an allocation of a portion of the value of the goods to each component may be necessary. Where, as here, one secured party has a security interest in the lessor's residual interest and another has a priority security interest in the chattel paper, it may be advisable for the conflicting secured parties to establish a method for making such an allocation and otherwise to determine their relative rights in returned goods by agreement.

§ 25-9-331. Priority of rights of purchasers of instruments, documents, and securities under other Articles; priority of interests in financial assets and security entitlements under Article 8.

(a) Rights under Articles 3, 7, and 8 not limited. — This Article does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated, or a protected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8 of this Chapter.

(b) Protection under Article 8. — This Article does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under Article 8 of this Chapter.

(c) Filing not notice. — Filing under this Article does not constitute notice of a claim or defense to the holders, or purchasers, or persons described in subsections (a) and (b) of this section. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(m), (n); 1997-181, s. 14; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-309.

2. **"Priority."** In some provisions, this article distinguishes between claimants that take collateral free of a security interest (in the sense that the security interest no longer encumbers the collateral) and those that take an interest in the collateral that is senior to a surviving security interest. See, e.g., section 9-317. Whether a holder or purchaser referred to in this section takes free or is senior to a security interest depends on whether the purchaser is a buyer of the collateral or takes a security interest in it. The term "priority" is meant to encompass both scenarios, as it does in section 9-330.

3. **Rights Acquired by Purchasers.** The rights to which this section refers are set forth in sections 3-305 and 3-306 (holder in due course), 7-502 (holder to whom a negotiable document of title has been duly negotiated), and 8-303 (protected purchaser). The holders and purchasers referred to in this section do not always take priority over a security interest. See, e.g., section 7-503 (affording paramount rights to certain owners and secured parties as against holder to whom a negotiable document of title has been duly negotiated). Accordingly, this section adds the clause, "to the extent provided in articles 3, 7, and 8" to former section 9-309.

4. **Financial Assets and Security Entitlements.** New subsection (b) provides explicit protection for those who deal with financial assets and security entitlements and who are immunized from liability under article 8. See, e.g., sections 8-502, 8-503(e), 8-510, and 8-511. The new subsection makes explicit in article 9 what is implicit in former article 9 and explicit in several provisions of article 8. It does not change the law.

5. **Collections by Junior Secured Party.** Under this section, a secured party with a junior security interest in receivables (accounts, chattel paper, promissory notes, or payment intangibles) may collect and retain the proceeds of those receivables free of the claim of a senior secured party to the same receivables, if the junior secured party is a holder in due course of the proceeds. In order to qualify as a holder in due course, the junior must satisfy the requirements of section 3-302, which include taking in "good faith." This means that the junior not only must act "honestly" but also must observe "reasonable commercial standards of fair dealing" under the particular circumstances. See section 9-102(a). Although "good faith" does not impose a general duty of inquiry, e.g., a search of the records in filing offices, there may be circumstances in which "reasonable commercial standards of fair dealing" would require such a search.

Consider, for example, a junior secured party in the business of financing or buying accounts who fails to undertake a search to determine the existence of prior security interests. Because a search, under the usages of trade of that business, would enable it to know or learn upon reasonable inquiry that collecting the accounts violated the rights of a senior secured party, the junior may fail to meet the good-faith standard. See Utility Contractors Financial Services, Inc. v. Amsouth Bank, NA, 985 F.2d 1554 (11th Cir. 1993). Likewise, a junior secured party who collects accounts when it knows or should know under the particular circumstances that doing so would violate the rights of a senior secured party, because the debtor had agreed not to grant a junior security interest in, or sell, the accounts, may not meet the good-faith test. Thus, if a junior secured party conducted or should have conducted a search and a financing statement filed on behalf of the senior secured party states such a restriction, the junior's collection would not meet the good-faith standard. On the other hand, if there was a course of performance between the senior secured party and the debtor which placed no such restrictions on the debtor and allowed the debtor to collect and use the proceeds without any restrictions, the junior secured party may then satisfy the requirements for being a holder in due course. This would be more likely in those circumstances where the junior secured party was providing additional financing to the debtor on an ongoing basis by lending against or buying the accounts and had no notice of any restrictions against doing so. Generally, the senior secured party would not be prejudiced because the practical effect of such payment to the junior secured party is little different than if the debtor itself had made the collections and subsequently paid the secured party from the debtor's general funds. Absent collusion, the junior secured party would take the funds free of the senior security interests. See section 9-332. In contrast, the senior secured party is likely to be prejudiced if the debtor is going out of business and the junior secured party collects the accounts by notifying the account debtors to make payments directly to the junior. Those collections may not be consistent with "reasonable commercial standards of fair dealing."

Whether the junior secured party qualifies as a holder in due course is fact-sensitive and should be decided on a case-by-case basis in the light of those circumstances. Decisions such as Financial Management Services Inc. v. Familian, 905 P.2d 506 (Ariz. App. Div. 1995) (finding holder in due course status) could be determined differently under this application of the good-faith requirement.

The concepts addressed in this comment are also applicable to junior secured parties as purchasers of instruments under section 9-330(d). See section 9-330, comment 7.

§ 25-9-332. Transfer of money; transfer of funds from deposit account.

(a) Transferee of money. — A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) Transferee of funds from deposit account. — A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope of This Section.** This section affords broad protection to transferees who take funds from a deposit account and to those who take money. The term "transferee" is not defined; however, the debtor itself is not a transferee. Thus this section does not cover the case in which a debtor withdraws money (currency) from its deposit account or the case in which a bank debits an encumbered account and credits another account it maintains for the debtor.

A transfer of funds from a deposit account, to which subsection (b) applies, normally will be made by check, by funds transfer, or by debiting the debtor's deposit account and crediting another depositor's account.

Example 1: Debtor maintains a deposit account with Bank A. The deposit account is subject to a perfected security interest in favor of Lender. Debtor draws a check on the account, payable to Payee. Inasmuch as the check is not the proceeds of the deposit account (it is an order to pay funds from the deposit account), Lender's security interest in the deposit account does not give rise to a security interest in the check. Payee deposits the check into its own deposit account, and Bank A pays it. Unless Payee acted in collusion with Debtor in violating Lender's rights, Payee takes the funds (the credits running in favor of Payee) free of Lender's security interest. This is true regardless of whether Payee is a holder in due course of the check and even if Payee gave no value for the check.

Example 2: Debtor maintains a deposit account with Bank A. The deposit account is subject to a perfected security interest in favor of Lender. At Bank B's suggestion, Debtor moves the funds from the account at Bank A to Debtor's deposit account with Bank B. Unless Bank B acted in collusion with Debtor in violating Lender's rights, Bank B takes the funds (the credits running in favor of Bank B) free from Lender's security interest. See subsection (b). However, inasmuch as the deposit account maintained with Bank B constitutes the proceeds of the deposit account at Bank A, Lender's security interest would attach to that account as proceeds. See section 9-315.

Subsection (b) also would apply if, in the example, Bank A debited Debtor's deposit account in exchange for the issuance of Bank A's cashier's check. Lender's security interest would attach to the cashier's check as proceeds of the deposit account, and the rules applicable to instruments would govern any competing claims to the cashier's check. See, e.g., sections 3-306, 9-322, 9-330, and 9-331.

If Debtor withdraws money (currency) from an encumbered deposit account and transfers the money to a third party, then subsection (a), to the extent not displaced by federal law relating to money, applies. It contains the same rule as subsection (b).

Subsection (b) applies to transfers of funds from a deposit account; it does not apply to transfers of the deposit account itself or of an interest therein. For example, this section does not apply to the creation of a security interest in a deposit account. Competing claims to the deposit account itself are dealt with by other article 9 priority rules. See sections 9-317(a), 9-327, 9-340, and 9-341. Similarly, a corporate merger normally would not result in a transfer of funds from a deposit account. Rather, it might result in a transfer of the deposit account itself. If so, the normal rules applicable to transferred collateral would apply; this section would not.

3. **Policy.** Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. It also minimizes the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even to place a completed transaction in jeopardy by bringing suit against the transferee of funds, should be severely limited. Although the giving of value usually is a prerequisite for receiving the ability to take free from third-party claims, where payments are concerned the law is even more protective. Thus, section 3-418(c) provides that, even where the law of restitution otherwise would permit recovery of funds paid by mistake, no recovery may be had from a person "who in good faith changed position in reliance on the payment." Rather than adopt this standard, this section eliminates all reliance requirements whatsoever. Payments made by mistake are relatively rare, but payments of funds from encumbered deposit accounts (e.g., deposit accounts containing collections from accounts receivable) occur with great regularity. In most cases, unlike payment by mistake, no one would object to these payments. In the vast proportion of cases, the transferee probably would be able to show a change of position in reliance on the payment. This section does not put the transferee to the burden of having to make this proof.

4. **"Bad Actors."** To deal with the question of the "bad actor," this section borrows "collusion" language from article 8. See, e.g., sections 8-115 and 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., section 1-201(9) ("without knowledge that the sale . . . is in violation of the . . . security interest"); section 1-201(19) ("honesty in fact in the conduct or transaction concerned"); and section 3-302(a)(2)(v) ("without notice of any claim").

5. **Transferee Who Does Not Take Free.** This section sets forth the circumstances under which certain transferees of money or funds take free of security interests. It does not determine the rights of a transferee who does not take free of a security interest.

Example 3: The facts are as in example 2, but, in wrongfully moving the funds from the deposit account at Bank A to Debtor's deposit account with Bank B, Debtor acts in collusion with Bank B. Bank B does not take the funds free of Lender's security interest under this section. If Debtor grants a security interest to Bank B, section 9-327 governs the relative priorities of Lender and Bank B. Under section 9-327(3), Bank B's security interest in the Bank B deposit account is senior to Lender's security interest in the deposit account as proceeds. However, Bank B's senior security interest does not protect Bank B against any liability to Lender that might arise from Bank B's wrongful conduct.

§ 25-9-333. Priority of certain liens arising by operation of law.

(a) "Possessory lien." — In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:

(1) Which secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;

(2) Which is created by statute or rule of law in favor of the person; and

(3) Whose effectiveness depends on the person's possession of the goods.

(b) Priority of possessory lien. — A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-310.

2. **"Possessory Liens."** This section governs the relative priority of security interests arising under this article and "possessory liens," i.e., common-law and statutory liens whose effectiveness depends on the lienor's possession of goods with respect to which the lienor provided services or furnished materials in the ordinary course of its business. As under former section 9-310, the possessory lien has priority over a security interest unless the possessory lien is created by a statute that expressly provides otherwise. If the statute creating the possessory lien is silent as to its priority relative to a security interest, this section provides a rule of interpretation that the possessory lien takes priority, even if the statute has been construed judicially to make the possessory lien subordinate.

Legal Periodicals. — For article concerning liens on personal property not governed by the UCC, see 44 N.C.L. Rev. 322 (1966).

§ 25-9-334. Priority of security interests in fixtures and crops.

(a) Security interest in fixtures under this Article. — A security interest under this Article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this Article in ordinary building materials incorporated into an improvement on land.

(b) Security interest in fixtures under real-property law. — This Article does not prevent creation of an encumbrance upon fixtures under real property law.

(c) General rule: subordination of security interest in fixtures. — In cases not governed by subsections (d) through (h) of this section, a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

(d) Fixtures purchase-money priority. — Except as otherwise provided in subsection (h) of this section, a perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property and:

(1) The security interest is a purchase-money security interest;

(2) The interest of the encumbrancer or owner arises before the goods become fixtures; and

(3) The security interest is perfected by a fixture filing before the goods become fixtures or within 20 days thereafter.

(e) Priority of security interest in fixtures over interests in real property. — A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) The debtor has an interest of record in the real property or is in possession of the real property and the security interest:

a. Is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and

b. Has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;

(2) Before the goods become fixtures, the security interest is perfected by any method permitted by this Article and the fixtures are readily removable:
  a. Factory or office machines;
  b. Equipment that is not primarily used or leased for use in the operation of the real property; or
  c. Replacements of domestic appliances that are consumer goods;

(3) The conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this Article; or

(4) The security interest is:
  a. Created in a manufactured home in a manufactured-home transaction; and
  b. Perfected pursuant to a statute described in G.S. 25-9-311(a)(2).

(f) Priority based on consent, disclaimer, or right to remove. — A security interest in fixtures, whether or not perfected, has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) The encumbrancer or owner has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures; or

(2) The debtor has a right to remove the goods as against the encumbrancer or owner.

(g) Continuation of subdivision (f)(2) priority. — The priority of the security interest under subdivision (f)(2) of this section continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates.

(h) Priority of construction mortgage. — A mortgage is a construction mortgage to the extent that it secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates. Except as otherwise provided in subsections (e) and (f) of this section, a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction. A mortgage has this priority to the same extent as a construction mortgage to the extent that it is given to refinance a construction mortgage.

(i) Priority of security interest in crops. — Except as provided in G.S. 42-15, a perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-313.

2. **Scope of This Section.** This section contains rules governing the priority of security interests in fixtures and crops as against persons who claim an interest in real property. Priority contests with other article 9 security interests are governed by the other priority rules of this article. The provisions with respect to fixtures follow those of former section 9-313. However, they have been rewritten to conform to section 2A-309 and to prevailing style conventions. Subsections (i) and (j), which apply to crops, are new.

3. **Security Interests in Fixtures.** Certain goods that are the subject of personal-property (chattel) financing become so affixed or otherwise so related to real property that they become part of the real property. These goods are called "fixtures." See section 9-102 (definition of "fixtures"). Some fixtures retain their personal property nature: A security interest under this article may be created in fixtures and may continue in goods that become fixtures. See subsection (a). However, if the goods are ordinary building materials incorporated into an improvement on land, no security interest in them exists. Rather, the priority of claims to the building materials are determined by the law

governing claims to real property. (Of course, the fact that no security interest exists in ordinary building materials incorporated into an improvement on land does not prejudice any rights the secured party may have against the debtor or any other person who violated the secured party's rights by wrongfully incorporating the goods into real property.)

Thus, this section recognizes three categories of goods: (1) Those that retain their chattel character entirely and are not part of the real property; (2) ordinary building materials that have become an integral part of the real property and cannot retain their chattel character for purposes of finance; and (3) an intermediate class that has become real property for certain purposes, but as to which chattel financing may be preserved.

To achieve priority under certain provisions of this section, a security interest must be perfected by making a "fixture filing" (defined in section 9-102) in the real property records. Because the question whether goods have become fixtures often is a difficult one under applicable real property law, a secured party may make a fixture filing as a precaution. Courts should not infer from a fixture filing that the secured party concedes that the goods are or will become fixtures.

4. **Priority in Fixtures: General.** In considering priority problems under this section, one must first determine whether real property claimants per se have an interest in the crops or fixtures as part of real property. If not, it is immaterial, so far as concerns real property parties as such, whether a security interest arising under this article is perfected or unperfected. In no event does a real property claimant (e.g., owner or mortgagee) acquire an interest in a "pure" chattel just because a security interest therein is unperfected. If on the other hand real property law gives real property parties an interest in the goods, a conflict arises and this section states the priorities.

5. **Priority in Fixtures: Residual Rule.** Subsection (c) states the residual priority rule, which applies only if one of the other rules does not: A security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

6. **Priority in Fixtures: First to File or Record.** Subsection (e)(1), which follows former section 9-313(4)(b), contains the usual priority rule of conveyancing, that is, the first to file or record prevails. In order to achieve priority under this rule, however, the security interest must be perfected by a "fixture filing" (defined in section 9-102), i.e., a filing for record in the real property records and indexed therein, so that it will be found in a real property search. The condition in subsection (e)(1)(B), that the security interest must have had priority over any conflicting interest of a predecessor in title of the conflicting encumbrancer or owner, appears to limit to the first-in-time principle. However, this apparent limitation is nothing other than an expression of the usual rule that a person must be entitled to transfer what he or she has. Thus, if the fixture security interest is subordinate to a mortgage, it is subordinate to an interest of an assignee of the mortgage, even though the assignment is a later recorded instrument. Similarly if the fixture security interest is subordinate to the rights of an owner, it is subordinate to a subsequent grantee of the owner and likewise subordinate to a subsequent mortgagee of the owner.

7. **Priority in Fixtures: Purchase-Money Security Interests.** Subsection (d), which follows former section 9-313(4)(a), contains the principal exception to the first-to-file-or-record rule of subsection (e)(1). It affords priority to purchase-money security interests in fixtures as against prior recorded real property interests, provided that the purchase-money security interest is filed as a fixture filing in the real property records before the goods become fixtures or within 20 days thereafter. This priority corresponds to the purchase-money priority under section 9-324(a). (Like other 10-day periods in former article 9, the 10-day period in this section has been changed to 20 days.)

It should be emphasized that this purchase-money priority with the 20-day grace period for filing is limited to rights against real property interests that arise before the goods become fixtures. There is no such priority with the 20-day grace period as against real property interests that arise subsequently. The fixture security interest can defeat subsequent real property interests only if it is filed first and prevails under the usual conveyancing rule in subsection (e)(1) or one of the other rules in this section.

8. **Priority in Fixtures: Readily Removable Goods.** Subsection (e)(2), which derives from section 2A-309 and former section 9-313(4)(d), contains another exception to the usual first-to-file-or-perfect rule. It affords priority to the holders of security interests in certain types of readily removable goods—factory and office machines, equipment that is not primarily used or leased for use in the operation of the real property, and (as discussed below) certain replacements of domestic appliances. This rule is made necessary by the confusion in the law as to whether certain machinery, equipment, and appliances become fixtures. It protects a secured party who, perhaps in the mistaken belief that the readily removable goods will not become fixtures, makes a UCC filing (or otherwise perfects under this article) rather than making a fixture filing.

Frequently, under applicable law, goods of the type described in subsection (e)(2) will not be considered to have become part of the real property. In those cases, the fixture security interest does not conflict with a real property interest, and resort to this section is unnecessary. However, if the goods have become part of the real property, subsection (e)(2) enables a fixture secured party to take priority over a conflicting real-property interest if the fixture security interest is perfected by a fixture filing or by any other method permitted by this article. If perfection is by fixture filing, the fixture security interest would have priority over subsequently recorded real property interests under subsection (e)(1) and, if the fixture security interest is a purchase-money security interest (a likely scenario), it would also have priority over most real property interests under the purchase-money priority of subsection (d). Note, however, that unlike the purchase-money priority rule in subsection (d), the priority rules in subsection (e) override the priority given to a construction mortgage under subsection (h).

The rule in subsection (e)(2) is limited to readily removable replacements of domestic appliances. It does not apply to original installations. Moreover, it is limited to appliances that are "consumer goods" (defined in section 9-102) in the hands of the debtor. The principal effect of the rule is to make clear that a secured party financing occasional replacements of domestic appliances in noncommercial, owner-occupied contexts need not concern itself with real-property descriptions or records; indeed, for a purchase-money replacement of consumer goods, perfection without any filing will be possible. See section 9-309(1).

9. **Priority in Fixtures: Judicial Liens.** Subsection (e)(3), which follows former section 9-313(4)(d), adopts a first-in-time rule applicable to conflicts between a fixture security interest and a lien on the real property obtained by legal or equitable proceedings. Such a lien is subordinate to an earlier-perfected security interest, regardless of the method by which the security interest was perfected. Judgment creditors generally are not reliance creditors who search real property records. Accordingly, a perfected fixture security interest takes priority over a subsequent judgment lien or other lien obtained by legal or equitable proceedings, even if no evidence of the security interest appears in the relevant real property records. Subsection (e)(3) thus protects a perfected fixture security interest from avoidance by a trustee in bankruptcy under Bankruptcy Code section 544(a), regardless of the method of perfection.

10. **Priority in Fixtures: Manufactured Homes.** A manufactured home may become a fixture. New subsection (e)(4) contains a special rule granting priority to certain security interests created in a "manufactured home" as part of a "manufactured-home transaction" (both defined in section 9-102). Under this rule, a security interest in a manufactured home that becomes a fixture has priority over a conflicting interest of an encumbrancer or owner of the real property if the security interest is perfected under a certificate of title statute (see section 9-311). Subsection (e)(4) is only one of the priority rules applicable to security interests in a manufactured home that becomes a fixture. Thus, a security interest in a manufactured home which does not qualify for priority under this subsection may qualify under another.

11. **Priority in Fixtures: Construction Mortgages.** The purchase-money priority presents a difficult problem in relation to construction mortgages. The latter ordinarily will have been recorded even before the commencement of delivery of materials to the job, and therefore would take priority over fixture security interests were it not for the purchase-money priority. However, having recorded first, the holder of a construction mortgage reasonably expects to have first priority in the improvement built using the mortgagee's advances. Subsection (g) expressly gives priority to the construction mortgage recorded before the filing of the purchase-money security interest in fixtures. A refinancing of a construction mortgage has the same priority as the construction mortgage itself. The phrase "an obligation incurred for the construction of an improvement" covers both optional advances and advances pursuant to commitment. Both types of advances have the same priority under subsection (g).

The priority under this subsection applies only to goods that become fixtures during the construction period leading to the completion of the improvement. The construction priority will not apply to additions to the building made long after completion of the improvement, even if the additions are financed by the real property mortgagee under an open-end clause of the construction mortgage. In such case, subsections (d), (e), and (f) govern.

Although this subsection affords a construction mortgage priority over a purchase-money security interest that otherwise would have priority under subsection (d), the subsection is subject to the priority rules in subsections (e) and (f). Thus, a construction mortgage may be junior to a fixture security interest perfected by a fixture filing before the construction mortgage was recorded. See subsection (e)(1).

12. **Crops.** Growing crops are "goods" in which a security interest may be created and perfected under this article. In some jurisdictions, a mortgage of real property may cover crops, as well. In the event that crops are encumbered by both a mortgage and an article 9 security interest, subsection (i) provides that the security interest has priority. States whose

real property law provides otherwise should either amend that law directly or override it by enacting subsection (j).

NORTH CAROLINA COMMENT

Under North Carolina law, manufactured homes may be deemed to be motor vehicles (see G.S. 20-50) and subject to the laws governing motor vehicles with respect to the perfection of security interests in them or to be an improvement to real property or real property (see G.S. 47-20.6 and G.S. 47-20.7) and subject to the laws governing real property with respect to the perfection of security interest in them.

Subsection (j) of the uniform text is omitted as unnecessary because of the addition to subsection (i) of the phrase "Except as provided in G.S. 42-15."

Legal Periodicals. — For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Creditor who did not file financing statement did not have perfected purchase money security interest in windows and gutters which were attached to and became a part of a house as over against the trustee in bankruptcy. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

Filing Did Not Determine Nature of Collateral. — Filing a fixture filing, in addition to purchase money security interest, is not determinative regarding the nature of the collateral; it is routinely done by creditors and often is merely precautionary. In re Walker, 173 Bankr. 512 (Bankr. M.D.N.C. 1994).

Secured Party Held Not Entitled to Possession of Barns. — Secured creditor was not entitled to possession of tobacco barns which had been determined to be fixtures where the debtor's right to remove the barns had terminated and secured party's security interest had expired. United States v. Gaskins, 748 F. Supp. 366 (E.D.N.C. 1990).

Security Interest in Mobile Home Affixed to Real Property. — A perfected lien noted on the certificate of title remains superior despite the annexation of the mobile home to realty. Hughes v. Young, 115 N.C. App. 325, 444 S.E.2d 248 (1994).

Once the title certificate has been issued for a mobile home and a creditor has perfected a lien upon the mobile home by registering its lien on the title certificate, the mobile home does not lose its status as a mobile home merely because the owner thereafter permanently affixes it to the land; therefore, the secured creditor with a lien on the title prevails over a subsequent creditor who takes a deed of trust on the land and mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

Where a duly licensed mobile home dealer purchased a doublewide from the manufacturer and attached it to a fixed, permanent foundation before transferring the lot and doublewide to the transferee, and the parties did not intend for the doublewide to be operated upon the highways, there was no requirement that the doublewide be registered or that a certificate of title be obtained by either party; therefore, the deed of trust created an encumbrance on both the land and the mobile home. In re Meade, 174 Bankr. 49 (Bankr. M.D.N.C. 1994).

No fixture filing was required, despite the fact that the mobile home was attached to realty, because G.S. 20-58 *et seq.* provides the exclusive method for a first mortgagee to perfect a security interest in a mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A mobile home is a motor vehicle, and is subject to the mandatory provisions of the statutes relating to the registration of motor vehicles in this State. King Homes, Inc. v. Bryson, 273 N.C. 84, 159 S.E.2d 329 (1968).

Vehicle "Required to be Registered." — A vehicle is "required to be registered" under this section only if the owner intends to operate it on state highways and only if the vehicle is not exempt from statutory registration requirements; both of these disjunctive requirements must be met before the vehicle is "required to be registered." Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

When Mobile Home is Not Vehicle. — Mobile home was not a motor vehicle "required to be registered," where it was permanently affixed to real estate and the owner had no intention to operate it on highways; thus, the creditor properly perfected his interest by recording a deed of trust for the real estate to which the mobile home was affixed. Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

§ 25-9-335. Accessions.

(a) Creation of security interest in accession. — A security interest may be created in an accession and continues in collateral that becomes an accession.

(b) Perfection of security interest. — If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the collateral.

(c) Priority of security interest. — Except as otherwise provided in subsection (d) of this section, the other provisions of this Part determine the priority of a security interest in an accession.

(d) Compliance with certificate-of-title statute. — A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under G.S. 25-9-311(b).

(e) Removal of accession after default. — After default, subject to Part 6 of this Article, a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of every person having an interest in the whole.

(f) Reimbursement following removal. — A secured party that removes an accession from other goods under subsection (e) of this section shall promptly reimburse any holder of a security interest or other lien on, or owner of, the whole or of the other goods, other than the debtor, for the cost of repair of any physical injury to the whole or the other goods. The secured party need not reimburse the holder or owner for any diminution in value of the whole or the other goods caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-314.

2. **"Accession."** This section applies to an "accession," as defined in section 9-102, regardless of the cost or difficulty of removing the accession from the other goods, and regardless of whether the original goods have come to form an integral part of the other goods. This section does not apply to goods whose identity has been lost. Goods of that kind are "commingled goods" governed by section 9-336. Neither this section nor the following one addresses the case of collateral that changes form without the addition of other goods.

3. **"Accession" vs. "Other Goods."** This section distinguishes among the "accession," the "other goods," and the "whole." The last term refers to the combination of the "accession" and the "other goods." If one person's collateral becomes physically united with another person's collateral, each is an "accession."

Example 1: SP-1 holds a security interest in the debtor's tractors (which are not subject to a certificate of title statute), and SP-2 holds a security interest in a particular tractor engine. The engine is installed in a tractor. From the perspective of SP-1, the tractor becomes an "accession" and the engine is the "other goods." From the perspective of SP-2, the engine is the "accession" and the tractor is the "other goods." The completed tractor—tractor cum engine—constitutes the "whole."

4. **Scope.** This section governs only a few issues concerning accessions. Subsection (a) contains rules governing continuation of a security interest in an accession. Subsection (b) contains a rule governing continued perfection of a security interest in goods that become an accession. Subsection (d) contains a special

priority rule governing accessions that become part of a whole covered by a certificate of title. Subsections (e) and (f) govern enforcement of a security interest in an accession.

5. **Matters Left to Other Provisions of This Article: Attachment and Perfection.** Other provisions of this article often govern accession-related issues. For example, this section does not address whether a secured party acquires a security interest in the whole if its collateral becomes an accession. Normally this will turn on the description of the collateral in the security agreement.

Example 2: Debtor owns a computer subject to a perfected security interest in favor of SP-1. Debtor acquires memory and installs it in the computer. Whether SP-1's security interest attaches to the memory depends on whether the security agreement covers it.

Similarly, this section does not determine whether perfection against collateral that becomes an accession is effective to perfect a security interest in the whole. Other provisions of this article, including the requirements for indicating the collateral covered by a financing statement, resolve that question.

6. **Matters Left to Other Provisions of This Article: Priority.** With one exception, concerning goods covered by a certificate of title (see subsection (d)), the other provisions of this part, including the rules governing purchase-money security interests, determine the priority of most security interests in an accession, including the relative priority of a security interest in an accession and a security interest in the whole. See subsection (c).

Example 3: Debtor owns an office computer subject to a security interest in favor of SP-1. Debtor acquires memory and grants a perfected security interest in the memory to SP-2. Debtor installs the memory in the computer, at which time (one assumes) SP-1's security interest attaches to the memory. The first-to-file-or-perfect rule of section 9-322 governs priority in the memory. If, however, SP-2's security interest is a purchase-money security interest, section 9-324(a) would afford priority in the memory to SP-2, regardless of which security interest was perfected first.

7. **Goods Covered by Certificate of Title.** This section does govern the priority of a security interest in an accession that is or becomes part of a whole that is subject to a security interest perfected by compliance with a certificate of title statute. Subsection (d) provides that a security interest in the whole, perfected by compliance with a certificate of title statute, takes priority over a security interest in the accession. It enables a secured party to rely upon a certificate of title without having to check the UCC files to determine whether any components of the collateral may be encumbered. The subsection imposes a corresponding risk upon those who finance goods that may become part of goods covered by a certificate of title. In doing so, it reverses the priority that appeared reasonable to most pre-UCC courts.

Example 4: Debtor owns an automobile subject to a security interest in favor of SP-1. The security interest is perfected by notation on the certificate of title. Debtor buys tires subject to a perfected-by-filing purchase-money security interest in favor of SP-2 and mounts the tires on the automobile's wheels. If the security interest in the automobile attaches to the tires, then SP-1 acquires priority over SP-2. The same result would obtain if SP-1's security interest attached to the automobile and was perfected after the tires had been mounted on the wheels.

CASE NOTES

Editor's Note. *— The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Where a bank had no notice of a loan collateral sale that a bankruptcy court consented to allow, the bank could collaterally attack the consent order; as the bank had priority with a superior interest in the collateral, it was entitled to summary judgment over the company who sold the collateral. First-Citizens Bank & Trust Co. v. Four Oaks Bank & Trust Co., 156 N.C. App. 378, 576 S.E.2d 722, 2003 N.C. App. LEXIS 127 (2003).

§ 25-9-336. Commingled goods.

(a) "Commingled goods." — In this section, "commingled goods" means goods that are physically united with other goods in such a manner that their identity is lost in a product or mass.

(b) No security interest in commingled goods as such. — A security interest does not exist in commingled goods as such. However, a security interest may attach to a product or mass that results when goods become commingled goods.

(c) Attachment of security interest to product or mass. — If collateral becomes commingled goods, a security interest attaches to the product or mass.

(d) Perfection of security interest. — If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest that attaches to the product or mass under subsection (c) of this section is perfected.

(e) Priority of security interest. — Except as otherwise provided in subsection (f) of this section, the other provisions of this Part determine the priority of a security interest that attaches to the product or mass under subsection (c) of this section.

(f) Conflicting security interests in product or mass. — If more than one security interest attaches to the product or mass under subsection (c) of this section, the following rules determine priority:

(1) A security interest that is perfected under subsection (d) of this section has priority over a security interest that is unperfected at the time the collateral becomes commingled goods.

(2) If more than one security interest is perfected under subsection (d) of this section, the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former section 9-315.

2. **"Commingled Goods."** Subsection (a) defines "commingled goods." It is meant to include not only goods whose identity is lost through manufacturing or production (e.g., flour that has become part of baked goods) but also goods whose identity is lost by commingling with other goods from which they cannot be distinguished (e.g., ball bearings).

3. **Consequences of Becoming "Commingled Goods."** By definition, the identity of the original collateral cannot be determined once the original collateral becomes commingled goods. Consequently, the security interest in the specific original collateral alone is lost once the collateral becomes commingled goods, and no security interest in the original collateral can be created thereafter except as a part of the resulting product or mass. See subsection (b).

Once collateral becomes commingled goods, the secured party's security interest is transferred from the original collateral to the product or mass. See subsection (c). If the security interest in the original collateral was perfected, the security interest in the product or mass is a perfected security interest. See subsection (d). This perfection continues until lapse.

4. **Priority of Perfected Security Interests That Attach Under This Section.** This section governs the priority of competing security interests in a product or mass only when both security interests arise under this section. In that case, if both security interests are perfected by operation of this section (see subsections (c) and (d)), then the security interests rank equally, in proportion to the value of the collateral at the time it became commingled goods. See subsection (f)(2).

Example 1: SP-1 has a perfected security interest in Debtor's eggs, which have a value of $300 and secure a debt of $400, and SP-2 has a perfected security interest in Debtor's flour, which has a value of $500 and secures a debt of $700. Debtor uses the flour and eggs to make cakes, which have a value of $1000. The two security interests rank equally and share in the ratio of 3:5. Applying this ratio to the entire value of the product, SP-1 would be entitled to $375 (i.e., 3/8 x $1000), and SP-2 would be entitled to $625 (i.e., 5/8 x $1000).

Example 2: Assume the facts of Example 1, except that SP-1's collateral, worth $300, secures a debt of $200. Recall that, if the cake is worth $1000, then applying the ratio of 3:5 would entitle SP-1 to $375 and SP-2 to $625. However, SP-1 is not entitled to collect from the product more than it is owed. Accordingly, SP-1's share would be only $200, SP-2 would receive the remaining value, up to the amount it is owed ($700).

Example 3: Assume that the cakes in the previous examples have a value of only $600. Again, the parties share in the ratio of 3:5. If, as in Example 1, SP-1 is owed $400, then SP-1 is entitled to $225 (i.e., 3/8 x $600), and SP-2 is entitled to $375 (i.e., 5/8 x $600). Debtor receives nothing. If, however, as in Example 2, SP-1 is owed only $200, then SP-2 receives $400.

The results in the foregoing examples remain the same, regardless of whether SP-1 or SP-2 (or each) has a purchase-money security interest.

5. **Perfection: Unperfected Security Interests.** The rule explained in the preceding comment applies only when both security interests in original collateral are perfected when the goods become commingled goods. If a secu-

rity interest in original collateral is unperfected at the time the collateral becomes commingled goods, subsection (f)(1) applies.

Example 4: SP-1 has a perfected security interest in the debtor's eggs, and SP-2 has an unperfected security interest in the debtor's flour. Debtor uses the flour and eggs to make cakes. Under subsection (c), both security interests attach to the cakes. But since SP-1's security interest was perfected at the time of commingling and SP-2's was not, only SP-1's security interest in the cakes is perfected. See subsection (d). Under subsection (f)(1) and section 9-322(a)(2), SP-1's perfected security interest has priority over SP-2's unperfected security interest.

If both security interests are unperfected, the rule of section 9-322(a)(3) would apply.

6. **Multiple Security Interests.** On occasion, a single input may be encumbered by more than one security interest. In those cases, the multiple secured parties should be treated like a single secured party for purposes of determining their collective share under subsection (f)(2). The normal priority rules would determine how that share would be allocated between them. Consider the following example, which is a variation on Example 1 above:

Example 5: SP-1A has a perfected, first-priority security interest in Debtor's eggs. SP-1B has a perfected, second-priority security interest in the same collateral. The eggs have a value of $300. Debtor owes $200 to SP-1A and $200 to SP-1B. SP-2 has a perfected security interest in Debtor's flour, which has a value of $500 and secures a debt of $600. Debtor uses the flour and eggs to make cakes, which have a value of $1000.

For purposes of subsection (f)(2), SP-1A and SP-1B should be treated like a single secured party. The collective security interest would rank equally with that of SP-2. Thus, the secured parties would share in the ratio of 3 (for SP-1A and SP-1B combined) to 5 (for SP-2). Applying this ratio to the entire value of the product, SP-1A and SP-1B in the aggregate would be entitled to $375 (i.e., 3/8 x $1000), and SP-2 would be entitled to $625 (i.e., 5/8 x $1000).

SP-1A and SP-1B would share the $375 in accordance with their priority, as established under other rules. Inasmuch as SP-1A has first priority, it would receive $200, and SP-1B would receive $175.

7. **Priority of Security Interests That Attach Other Than by Operation of This Section.** Under subsection (e), the normal priority rules determine the priority of a security interest that attaches to the product or mass other than by operation of this section. For example, assume that SP-1 has a perfected security interest in Debtor's existing and after-acquired baked goods, and SP-2 has a perfected security interest in Debtor's flour. When the flour is processed into cakes, subsections (c) and (d) provide that SP-2 acquires a perfected security interest in the cakes. If SP-1 filed against the baked goods before SP-2 filed against the flour, then SP-1 will enjoy priority in the cakes. See section 9-322 (first-to-file-or-perfect). But if SP-2 filed against the flour before SP-1 filed against the baked goods, then SP-2 will enjoy priority in the cakes to the extent of its security interest.

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

§ 25-9-337. Priority of security interests in goods covered by certificate of title.

If, while a security interest in goods is perfected by any method under the law of another jurisdiction, this State issues a certificate of title that does not show that the goods are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate:

(1) A buyer of the goods, other than a person in the business of selling goods of that kind, takes free of the security interest if the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and

(2) The security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected under G.S. 25-9-311(b), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess.,

1990), c. 1024, s. 8(e), (f); 1997-181, s. 2; 1999-73, s. 4(a), (b); 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Derived from former section 9-103(2)(d).

2. **Protection for Buyers and Secured Parties.** This section affords protection to certain good-faith purchasers for value who are likely to have relied on a "clean" certificate of title, i.e., one that neither shows that the goods are subject to a particular security interest nor contains a statement that they may be subject to security interests not shown on the certificate. Under this section, a buyer can take free of, and the holder of a conflicting security interest can acquire priority over, a security interest that is perfected by any method under the law of another jurisdiction. The fact that the security interest has been reperfected by possession under section 9-313 does not of itself disqualify the holder of a conflicting security interest from protection under paragraph (2).

§ 25-9-338. Priority of security interest or agricultural lien perfected by filed financing statement providing certain incorrect information.

If a security interest or agricultural lien is perfected by a filed financing statement providing information described in G.S. 25-9-516(b)(5) which is incorrect at the time the financing statement is filed:

(1) The security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and

(2) A purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of tangible chattel paper, tangible documents, goods, instruments, or a security certificate, receives delivery of the collateral. (2000-169, s. 1; 2006-112, s. 54.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Effect of Incorrect Information in Financing Statement.** Section 9-520(a) requires the filing office to reject financing statements that do not contain information concerning the debtor as specified in section 9-516(b)(5). An error in this information does not render the financing statement ineffective. On rare occasions, a subsequent purchaser of the collateral (i.e., a buyer or secured party) may rely on the misinformation to its detriment. This section subordinates a security interest or agricultural lien perfected by an effective, but flawed, financing statement to the rights of a buyer or holder of a perfected security interest to the extent that, in reasonable reliance on the incorrect information, the purchaser gives value and, in the case of tangible collateral, receives delivery of the collateral. A purchaser who has not made itself aware of the information in the filing office with respect to the debtor cannot act in "reasonable reliance" upon incorrect information.

3. **Relationship to Section 9-507.** This section applies to financing statements that contain information that is incorrect at the time of filing and imposes a small risk of subordination on the filer. In contrast, section 9-507 deals with financing statements containing information that is correct at the time of filing but which becomes incorrect later. Except as provided in section 9-507 with respect to changes in the debtor's name, an otherwise effective financing statement does not become ineffective if the information contained in it becomes inaccurate.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 54, effective October 1, 2006, inserted "tangible" two times in subdivision (2).

§ 25-9-339. Priority subject to subordination.

This Article does not preclude subordination by agreement by a person entitled to priority. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-316.

2. **Subordination by Agreement.** The preceding sections deal elaborately with questions of priority. This section makes it entirely clear that a person entitled to priority may effectively agree to subordinate its claim. Only the person entitled to priority may make such an agreement: A person's rights cannot be adversely affected by an agreement to which the person is not a party.

CASE NOTES

Cited in Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

Subpart 4. Rights of Banks.

§ 25-9-340. Effectiveness of right of recoupment or setoff against deposit account.

(a) Exercise of recoupment or setoff. — Except as otherwise provided in subsection (c) of this section, a bank with which a deposit account is maintained may exercise any right of recoupment or setoff against a secured party that holds a security interest in the deposit account.

(b) Recoupment or setoff not affected by security interest. — Except as otherwise provided in subsection (c) of this section, the application of this Article to a security interest in a deposit account does not affect a right of recoupment or setoff of the secured party as to a deposit account maintained with the secured party.

(c) When setoff ineffective. — The exercise by a bank of a setoff against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under G.S. 25-9-104(a)(3), if the setoff is based on a claim against the debtor. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; subsection (b) is based on a nonuniform Illinois amendment.

2. **Set-off vs. Security Interest.** This section resolves the conflict between a security interest in a deposit account and the bank's rights of recoupment and set-off.

Subsection (a) states the general rule and provides that the bank may effectively exercise rights of recoupment and set-off against the secured party. Subsection (c) contains an exception: If the secured party has control under section 9-104(a)(3) (i.e., if it has become the bank's customer), then any set-off exercised by the bank against a debt owed by the debtor (as opposed to a debt owed to the bank by the secured party) is ineffective. The bank may, however, exercise its recoupment rights effectively. This result is consistent with the priority rule in section 9-327(4), under which the security interest of a bank in a deposit account is subordinate to that of a secured party who has control under section 9-104(a)(3).

This section deals with rights of set-off and recoupment that a bank may have under other law. It does not create a right of set-off or recoupment, nor is it intended to override any limitations or restrictions that other law imposes on the exercise of those rights.

3. **Preservation of Set-Off Right.** Subsection (b) makes clear that a bank may hold both a right of set-off against, and an article 9 security interest in, the same deposit account. By holding a security interest in a deposit account, a bank does not impair any right of set-off it would otherwise enjoy. This subsection does not pertain to accounts evidenced by an instrument (e.g., certain certificates of deposit), which are excluded from the definition of "deposit accounts."

§ 25-9-341. Bank's rights and duties with respect to deposit account.

Except as otherwise provided in G.S. 25-9-340(c), and unless the bank otherwise agrees in an authenticated record, a bank's rights and duties with respect to a deposit account maintained with the bank are not terminated, suspended, or modified by:

(1) The creation, attachment, or perfection of a security interest in the deposit account;
(2) The bank's knowledge of the security interest; or
(3) The bank's receipt of instructions from the secured party. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Free Flow of Funds.** This section is designed to prevent security interests in deposit accounts from impeding the free flow of funds through the payment system. Subject to two exceptions, it leaves the bank's rights and duties with respect to the deposit account and the funds on deposit unaffected by the creation or perfection of a security interest or by the bank's knowledge of the security interest. In addition, the section permits the bank to ignore the instructions of the secured party unless it had agreed to honor them or unless other law provides to the contrary. A secured party who wishes to deprive the debtor of access to funds on deposit or to appropriate those funds for itself needs to obtain the agreement of the bank, utilize the judicial process, or comply with procedures set forth in other law. Section 4-303(a), concerning the effect of notice on a bank's right and duty to pay items, is not to the contrary. That section addresses only whether an otherwise effective notice comes too late; it does not determine whether a timely notice is otherwise effective.

3. **Operation of Rule.** The general rule of this section is subject to section 9-340(c), under which a bank's right of set-off may not be exercised against a deposit account in the secured party's name if the right is based on a claim against the debtor. This result reflects current law in many jurisdictions and does not appear to have unduly disrupted banking practices or the payments system. The more important function of this section, which is not impaired by section 9-340, is the bank's right to follow the debtor's (customer's) instructions (e.g., by honoring checks, permitting withdrawals, etc.) until such time as the depository institution is served with judicial process or receives instructions with respect to the funds on deposit from a secured party who has control over the deposit account.

4. **Liability of Bank.** This article does not determine whether a bank that pays out funds

from an encumbered deposit is liable to the holder of a security interest. Although the fact that a secured party has control over the deposit account and the manner by which control was achieved may be relevant to the imposition of liability, whatever rule applies generally when a bank pays out funds in which a third party has an interest would determine liability to a secured party. Often, this rule is found in a non-UCC adverse claim statute.

5. **Certificates of Deposit.** This section does not address the obligations of banks that issue instruments evidencing deposits (e.g., certain certificates of deposit).

§ 25-9-342. Bank's right to refuse to enter into or disclose existence of control agreement.

This Article does not require a bank to enter into an agreement of the kind described in G.S. 25-9-104(a)(2), even if its customer so requests or directs. A bank that has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; derived from section 8-106(g).

2. **Protection for Bank.** This section protects banks from the need to enter into agreements against their will and from the need to respond to inquiries from persons other than their customers.

PART 4.

Rights of Third Parties.

§ 25-9-401. Alienability of debtor's rights.

(a) Other law governs alienability; exceptions. — Except as otherwise provided in subsection (b) of this section and G.S. 25-9-406, 25-9-407, 25-9-408, and 25-9-409, whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this Article.

(b) Agreement does not prevent transfer. — An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-311.

2. **Scope of This Part.** This part deals with several issues affecting third parties (i.e., parties other than the debtor and the secured party). These issues are not addressed in part 3, subpart 3, which deals with priorities. This part primarily addresses the rights and duties of account debtors and other persons obligated on collateral who are not, themselves, parties to a secured transaction.

3. **Governing Law.** There was some uncertainty under former article 9 as to which jurisdiction's law (usually, which jurisdiction's version of article 9) applied to the matters that this part addresses. Part 3, subpart 1, does not determine the law governing these matters because they do not relate to perfection, the effect of perfection or nonperfection, or priority. However, it might be inappropriate for a designation of applicable law by a debtor and secured party under section 1-105 to control the law applicable to an independent transaction or relationship between the debtor and an account debtor.

Consider an example under section 9-408:

Example 1: State X has adopted this article; former article 9 is the law of State Y. A general intangible (e.g., a franchise agreement) between a debtor-franchisee, D, and an account debtor-franchisor, AD, is governed by the law of State Y. D grants to SP a security interest in its rights under the franchise agreement. The franchise agreement contains a term prohibiting D's assignment of its rights under the agreement. D and SP agree that their secured transaction is governed by the law of State X. Under State X's section 9-408, the restriction on D's assignment is ineffective to prevent the creation, attachment, or perfection of SP's security interest. State Y's former section 9-318(4), however, does not address restrictions on the creation of security interests in general intangibles other than general intangibles for money due or to become due. Accordingly, it does not address restrictions on the assignment to SP of D's rights under the franchise agreement. The non-article-9 law of State Y, which does address restrictions, provides that the prohibition on assignment is effective.

This article does not provide a specific answer to the question of which State's law applies to the restriction on assignment in the example. However, assuming that under non-UCC choice-of-law principles the effectiveness of the restriction would be governed by the law of State Y, which governs the franchise agreement, the fact that State X's article 9 governs the secured transaction between SP and D would not override the otherwise applicable law governing the agreement. Of course, to the extent that jurisdictions eventually adopt identical versions of this article and courts interpret it consistently, the inability to identify the applicable law in circumstances such as those in the example may be inconsequential.

4. **Inalienability Under Other Law.** Subsection (a) addresses the question whether property necessarily is transferable by virtue of its inclusion (i.e., its eligibility as collateral) within the scope of article 9. It gives a negative answer, subject to the identified exceptions. The substance of subsection (a) was implicit under former article 9.

5. **Negative Pledge Covenant.** Subsection (b) is an exception to the general rule in subsection (a). It makes clear that in secured transactions under this article the debtor has rights in collateral (whether legal title or equitable) which it can transfer and which its creditors can reach. It is best explained with an example:

Example 2: A debtor, D, grants to SP a security interest to secure a debt in excess of the value of the collateral. D agrees with SP that it will not create a subsequent security interest in the collateral and that any security interest purportedly granted in violation of the agreement will be void. Subsequently, in violation of its agreement with SP, D purports to grant a security interest in the same collateral to another secured party.

Subsection (b) validates D's creation of the subsequent (prohibited) security interest, which might even achieve priority over the earlier security interest. See comment 7. However, unlike some other provisions of this part, such as section 9-406, subsection (b) does not provide that the agreement restricting assignment itself is "ineffective. " Consequently, the debtor's breach may create a default.

6. **Rights of Lien Creditors.** Difficult problems may arise with respect to attachment, levy, and other judicial procedures under which a debtor's creditors may reach collateral subject to a security interest. For example, an obligation may be secured by collateral worth many times the amount of the obligation. If a lien creditor has caused all or a portion of the collateral to be seized under judicial process, it may be difficult to determine the amount of the debtor's "equity " in the collateral that has been seized. The section leaves resolution of this problem to the courts. The doctrine of marshaling may be appropriate.

7. **Sale of Receivables.** If a debtor sells an account, chattel paper, payment intangible, or promissory note outright, as against the buyer the debtor has no remaining rights to transfer. If, however, the buyer fails to perfect its interest, then solely insofar as the rights of certain third parties are concerned, the debtor is deemed to retain its rights and title. See section 9-318. The debtor has the power to convey these rights to a subsequent purchaser. If the subsequent purchaser (buyer or secured lender) perfects its interest, it will achieve priority over the earlier, unperfected purchaser. See section 9-322(a)(1).

§ 25-9-402. Secured party not obligated on contract of debtor or in tort.

The existence of a security interest, agricultural lien, or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-317.

2. **Nonliability of Secured Party.** This section, like former section 9-317, rejects theories on which a secured party might be held liable on a debtor's contracts or in tort merely because a security interest exists or because

the debtor is entitled to dispose of or use collateral. This section expands former section 9-317 to cover agricultural liens.

§ 25-9-403. Agreement not to assert defenses against assignee.

(a) "Value." — In this section, "value" has the meaning provided in G.S. 25-3-303(a).

(b) Agreement not to assert claim or defense. — Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:

(1) For value;
(2) In good faith;
(3) Without notice of a claim of a property or possessory right to the property assigned; and
(4) Without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under G.S. 25-3-305(a).

(c) When subsection (b) not applicable. — Subsection (b) of this section does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under G.S. 25-3-305(b).

(d) Omission of required statement in consumer transaction. — In a consumer transaction, if a record evidences the account debtor's obligation, law other than this Article requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement:

(1) The record has the same effect as if the record included such a statement; and
(2) The account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.

(e) Rule for individual under other law. — This section is subject to law other than this Article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(f) Other law not displaced. — Except as otherwise provided in subsection (d) of this section, this section does not displace law other than this Article which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-206.

2. **Scope and Purpose.** Subsection (b), like former section 9-206, generally validates an agreement between an account debtor and an assignor that the account debtor will not assert against an assignee claims and defenses that it may have against the assignor. These agreements are typical in installment sale agreements and leases. However, this section expands former section 9-206 to apply to all account debtors; it is not limited to account debtors that have bought or leased goods. This section applies only to the obligations of an "account debtor," as defined in section 9-102. Thus, it does not determine the circumstances under which and the extent to which a person who is obligated on a negotiable instrument is disabled from asserting claims and defenses. Rather, article 3 must be consulted. See, e.g., sections 3-305 and 3-306. Article 3 governs even

when the negotiable instrument constitutes part of chattel paper. See section 9-102 (an obligor on a negotiable instrument constituting part of chattel paper is not an "account debtor").

3. **Conditions of Validation; Relationship to Article 3.** Subsection (b) validates an account debtor's agreement only if the assignee takes an assignment for value, in good faith, and without notice of conflicting claims to the property assigned or of certain claims or defenses of the account debtor. Like former section 9-206, this section is designed to put the assignee in a position that is no better and no worse than that of a holder in due course of a negotiable instrument under article 3. However, former section 9-206 left open certain issues, e.g., whether the section incorporated the special article 3 definition of "value" in section 3-303 or the generally applicable definition in section 1-201(44). Subsection (a) addresses this question; it provides that "value" has the meaning specified in section 3-303(a). Similarly, subsection (c) provides that subsection (b) does not validate an agreement with respect to defenses that could be asserted against a holder in due course under section 3-305(b) (the so-called "real" defenses). In 1990, the definition of "holder in due course" (section 3-302) and the articulation of the rights of a holder in due course (sections 3-305 and 3-306) were revised substantially. This section tracks more closely the rules of sections 3-302, 3-305, and 3-306.

4. **Relationship to Terms of Assigned Property.** Former section 9-206(2), concerning warranties accompanying the sale of goods, has been deleted as unnecessary. This article does not regulate the terms of the account, chattel paper, or general intangible that is assigned, except insofar as the account, chattel paper, or general intangible itself creates a security interest (as often is the case with chattel paper). Thus, article 2, and not this article, determines whether a seller of goods makes or effectively disclaims warranties, even if the sale is secured. Similarly, other law, and not this article, determines the effectiveness of an account debtor's undertaking to pay notwithstanding, and not to assert, any defenses or claims against an assign*or*—e.g., a "hell-or-high-water" provision in the underlying agreement that is assigned. If other law gives effect to this undertaking, then, under principles of *nemo dat,* the undertaking would be enforceable by the assignee (secured party). If other law prevents the assignor from enforcing the undertaking, this section nevertheless might permit the assignee to do so. The right of the assignee to enforce would depend upon whether, under the particular facts, the account debtor's undertaking fairly could be construed as an agreement that falls within the scope of this section and whether the assignee meets the requirements of this section.

5. **Relationship to Federal Trade Commission Rule.** Subsection (d) is new. It applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433, 16 C.F.R. part 433 (the "Holder-in-Due-Course Regulations"). Under this subsection, an assignee of such a record takes subject to the consumer account debtor's claims and defenses to the same extent as it would have if the writing had contained the required notice. Thus, subsection (d) effectively renders waiver-of-defense clauses ineffective in the transactions with consumers to which it applies.

6. **Relationship to Other Law.** Like former section 9-206(1), this section takes no position on the enforceability of waivers of claims and defenses by consumer account debtors, leaving that question to other law. However, the reference to "law other than this article" in subsection (e) encompasses administrative rules and regulations; the reference in former section 9-206(1) that it replaces ("statute or decision") arguably did not.

This section does not displace other law that gives effect to a nonconsumer account debtor's agreement not to assert defenses against an assignee, even if the agreement would not qualify under subsection (b). See subsection (f). It validates, but does not invalidate, agreements made by a nonconsumer account debtor. This section also does not displace other law to the extent that the other law permits an assignee, who takes an assignment with notice of a claim of a property or possessory right, a defense, or a claim in recoupment, to enforce an account debtor's agreement not to assert claims and defenses against the assignor (e.g., a "hell-or-high-water" agreement). See comment 4. It also does not displace an assignee's right to assert that an account debtor is estopped from asserting a claim or defense. Nor does this section displace other law with respect to waivers of potential future claims and defenses that are the subject of an agreement between the account debtor and the assignee. Finally, it does not displace section 1-107, concerning waiver of a breach that allegedly already has occurred.

Legal Periodicals. — For article on waiver of defense clauses in consumer contracts, see 48 N.C.L. Rev. 545 (1970).

CASE NOTES

***Editor's Note.** — The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Leases. — Former G.S. 25-9-207 applied to leases, whether or not they constituted secured transactions. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

Former G.S. 25-9-207 governed lease of drill and truck, even if the lease was not a transaction intended to create a security interest. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

Handwritten agreement between lessees/obligators and representative of lessor/obligee limiting remedies did not qualify as a defense which could be asserted against assignee as a limitation of remedies. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

§ 25-9-404. Rights acquired by assignee; claims and defenses against assignee.

(a) Assignee's rights subject to terms, claims, and defenses; exceptions. — Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e) of this section, the rights of an assignee are subject to:

(1) All terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(2) Any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) Account debtor's claim reduces amount owed to assignee. — Subject to subsection (c) of this section and except as otherwise provided in subsection (d) of this section, the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) of this section only to reduce the amount the account debtor owes.

(c) Rule for individual under other law. — This section is subject to law other than this Article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) Omission of required statement in consumer transaction. — In a consumer transaction, if a record evidences the account debtor's obligation, law other than this Article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) Inapplicability to health-care-insurance receivable. — This section does not apply to an assignment of a health-care-insurance receivable. (1945, c. 196, s. 6; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-318(1).

2. **Purpose; Rights of Assignee in General.** Subsection (a), like former section 9-318(1), provides that an assignee generally takes an assignment subject to defenses and claims of an account debtor. Under subsection (a)(1), if the account debtor's defenses on an assigned claim arise from the transaction that gave rise to the contract with the assignor, it makes no difference whether the defense or claim accrues before or after the account debtor is notified of the assignment. Under subsection (a)(2), the assignee takes subject to other defenses or claims only if they accrue before the account debtor has been notified of the assignment. Of course, an account debtor may waive

its right to assert defenses or claims against an assignee under section 9-403 or other applicable law. Subsection (a) tracks section 3-305(a)(3) more closely than its predecessor.

3. **Limitation on Affirmative Claims.** Subsection (b) is new. It limits the claim that the account debtor may assert against an assignee. Borrowing from section 3-305(a)(3) and cases construing former section 9-318, subsection (b) generally does not afford the account debtor the right to an affirmative recovery from an assignee.

4. **Consumer Account Debtors; Relationship to Federal Trade Commission Rule.** Subsections (c) and (d) also are new. Subsection (c) makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors. An "account debtor who is an individual" as used in subsection (c) includes individuals who are jointly or jointly and severally obligated. Subsection (d) applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433, 16 C.F.R. part 433 (the "Holder-in-Due-Course Regulations"). Under subsection (d), a consumer account debtor has the same right to an affirmative recovery from an assignee of such a record as the consumer would have had against the assignee had the record contained the required notice.

5. **Scope; Application to "Account Debtor."** This section deals only with the rights and duties of "account debtors"—and for the most part only with account debtors on accounts, chattel paper, and payment intangibles. Subsection (e) provides that the obligation of an insurer with respect to a health care insurance receivable is governed by other law. References in this section to an "account debtor" include account debtors on collateral that is proceeds. Neither this section nor any other provision of this article, including sections 9-408 and 9-409, provides analogous regulation of the rights and duties of other obligors on collateral, such as the maker of a negotiable instrument (governed by article 3), the issuer of or nominated person under a letter of credit (governed by article 5), or the issuer of a security (governed by article 8). Article 9 leaves those rights and duties untouched; however, section 9-409 deals with the special case of letters of credit. When chattel paper is composed in part of a negotiable instrument, the obligor on the instrument is not an "account debtor," and article 3 governs the rights of the assignee of the chattel paper with respect to the issues that this section addresses. See, e.g., section 3-601 (dealing with discharge of an obligation to pay a negotiable instrument).

CASE NOTES

***Editor's Note.** — The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

For case discussing what defenses against the assignor can be asserted against the assignee, see In re Governor's Island, 39 Bankr. 417 (Bankr. E.D.N.C. 1984).

The assignee of a nonnegotiable chose in action takes it subject to all defenses which the debtor may have had against the assignor based on facts existing at the time of the assignment or on facts arising thereafter but prior to the debtor's knowledge of the assignment. In re Governor's Island, 39 Bankr. 417 (Bankr. E.D.N.C. 1984).

§ 25-9-405. Modification of assigned contract.

(a) Effect of modification on assignee. — A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection is subject to subsections (b) through (d) of this section.

(b) Applicability of subsection (a). — Subsection (a) of this section applies to the extent that:

(1) The right to payment or a part thereof under an assigned contract has not been fully earned by performance; or

(2) The right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under G.S. 25-9-406(a).

(c) Rule for individual under other law. — This section is subject to law other than this Article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) Inapplicability to health-care-insurance receivable. — This section does not apply to an assignment of a health-care-insurance receivable. (1945, c. 196, s. 6; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-318(2).

2. **Modification of Assigned Contract.** The ability of account debtors and assignors to modify assigned contracts can be important, especially in the case of government contracts and complex contractual arrangements (e.g., construction contracts) with respect to which modifications are customary. Subsections (a) and (b) provide that good-faith modifications of assigned contracts are binding against an assignee to the extent that (i) the right to payment has not been fully earned or (ii) the right to payment has been earned and notification of the assignment has not been given to the account debtor. Former section 9-318(2) did not validate modifications of fully-performed contracts under any circumstances, whether or not notification of the assignment had been given to the account debtor. Subsection (a) protects the interests of assignees by (i) limiting the effectiveness of modifications to those made in good faith, (ii) affording the assignee with corresponding rights under the contract as modified, and (iii) recognizing that the modification may be a breach of the assignor's agreement with the assignee.

3. **Consumer Account Debtors.** Subsection (c) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

4. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (d) also is new. It provides that this section does not apply to an assignment of a health-care-insurance receivable. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law.

§ 25-9-406. Discharge of account debtor; notification of assignment; identification and proof of assignment; restrictions on assignment of accounts, chattel paper, payment intangibles, and promissory notes ineffective.

(a) Discharge of account debtor; effect of notification. — Subject to subsections (b) through (i) of this section, an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) When notification ineffective. — Subject to subsection (h) of this section, notification is ineffective under subsection (a) of this section:

(1) If it does not reasonably identify the rights assigned;

(2) To the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this Article; or

(3) At the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

a. Only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

b. A portion has been assigned to another assignee; or

c. The account debtor knows that the assignment to that assignee is limited.

(c) Proof of assignment. — Subject to subsection (h) of this section, if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (a) of this section.

(d) Term restricting assignment generally ineffective. — Except as otherwise provided in subsection (e) of this section and G.S. 25-2A-303 and G.S. 25-9-407 and subject to subsection (h) of this section, a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) Prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(e) Inapplicability of subsection (d) to certain sales. — Subsection (d) of this section does not apply to the sale of a payment intangible or promissory note.

(f) Legal restrictions on assignment generally ineffective. — Except as otherwise provided in G.S. 25-2A-303 and G.S. 25-9-407 and subject to subsections (h) and (i) of this section, a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(1) Prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

(g) Subdivision (b)(3) not waivable. — Subject to subsection (h) of this section, an account debtor may not waive or vary its option under subdivision (b)(3) of this section.

(h) Rule for individual under other law. — This section is subject to law other than this Article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(i) Inapplicability. — This section does not apply to an assignment of a health-care-insurance receivable. Subsection (f) of this section does not apply to an assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, a right the transfer of which is prohibited or restricted by any of the following statutes to the extent that the statute is inconsistent with subsection (f) of this section: North Carolina Structured Settlement Act (Article 44B of Chapter 1 of the General Statutes); North Carolina Crime Victims Compensation Act (Chapter 15B of the General Statutes); North Carolina Consumer Finance Act (Article 15 of Chapter 53 of the General Statutes); North Carolina Firemen's and Rescue Squad Workers' Pension Fund (Article 86 of Chapter 58 of the General Statutes); Employment

Security Law (Chapter 96 of the General Statutes); North Carolina Workers' Compensation Fund Act (Article 1 of Chapter 97 of the General Statutes); and Programs of Public Assistance (Article 2 of Chapter 108A of the General Statutes).

(j) Section prevails over inconsistent law. — Except to the extent otherwise provided in subsection (i) of this section, this section prevails over any inconsistent provision of an existing or future statute, rule, or regulation of this State unless the provision is contained in a statute of this State, refers expressly to this section, and states that the provision prevails over this section. (1945, c. 196, s. 6; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-318(3), (4).

2. **Account Debtor's Right to Pay Assignor Until Notification.** Subsection (a) provides the general rule concerning an account debtor's right to pay the assignor until the account debtor receives appropriate notification. The revision makes clear that once the account debtor receives the notification, the account debtor cannot discharge its obligation by paying the assignor. It also makes explicit that payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation. No change in meaning from former section 9-318 is intended. Nothing in this section conditions the effectiveness of a notification on the identity of the person who gives it. An account debtor that doubts whether the right to payment has been assigned may avail itself of the procedures in subsection (c). See comment 4.

An effective notification under subsection (a) must be authenticated. This requirement normally could be satisfied by sending notification on the notifying person's letterhead or on a form on which the notifying person's name appears. In each case the printed name would be a symbol adopted by the notifying person for the purpose of identifying the person and adopting the notification. See section 9-102 (defining "authenticate").

Subsection (a) applies only to account debtors on accounts, chattel paper, and payment intangibles. (Section 9-102 defines the term "account debtor" more broadly, to include those obligated on all general intangibles.) Although subsection (a) is more precise than its predecessor, it probably does not change the rule that applied under former article 9. Former section 9-318(3) referred to the account debtor's obligation to "pay," indicating that the subsection was limited to account debtors on accounts, chattel paper, and other payment obligations.

3. **Limitations on Effectiveness of Notification.** Subsection (b) contains some special rules concerning the effectiveness of a notification under subsection (a).

Subsection (b)(1) tracks former section 9-318(3) by making ineffective a notification that does not reasonably identify the rights assigned. A reasonable identification need not identify the right to payment with specificity, but what is reasonable also is not left to the arbitrary decision of the account debtor. If an account debtor has doubt as to the adequacy of a notification, it may not be safe in disregarding the notification unless it notifies the assignee with reasonable promptness as to the respects in which the account debtor considers the notification defective.

Subsection (b)(2), which is new, applies only to sales of payment intangibles. It makes a notification ineffective to the extent that other law gives effect to an agreement between an account debtor and a seller of a payment intangible that limits the account debtor's duty to pay a person other than the seller. Payment intangibles are substantially less fungible than accounts and chattel paper. In some (e.g., commercial bank loans), account debtors customarily and legitimately expect that they will not be required to pay any person other than the financial institution that has advanced funds.

It has become common in financing transactions to assign interests in a single obligation to more than one assignee. Requiring an account debtor that owes a single obligation to make multiple payments to multiple assignees would be unnecessarily burdensome. Thus, under subsection (b)(3), an account debtor that is notified to pay an assignee less than the full amount of any installment or other periodic payment has the option to treat the notification as ineffective, ignore the notice, and discharge the assigned obligation by paying the assignor. Some account debtors may not realize that the law affords them the right to ignore certain notices of assignment with impunity. By making the notification ineffective at the account debtor's option, subsection (b)(3) permits an account debtor to pay the assignee in accordance with the notice and thereby to satisfy its obligation pro tanto. Under subsection (g), the rights and duties created by subsection (b)(3) cannot be waived or varied.

4. **Proof of Assignment.** Subsection (c) links payment with discharge, as in subsection (a). It follows former section 9-318(3) in referring to the right of the account debtor to pay the assignor if the requested proof of assignment is not seasonably forthcoming. Even if the proof is not forthcoming, the notification of assignment would remain effective, so that, in the absence of reasonable proof of the assignment, the account debtor could discharge the obligation by paying either the assignee or the assignor. Of course, if the assignee did not in fact receive an assignment, the account debtor cannot discharge its obligation by paying a putative assignee who is a stranger. The observations in comment 3 concerning the reasonableness of an identification of a right to payment also apply here. An account debtor that questions the adequacy of proof submitted by an assignor would be well advised to promptly inform the assignor of the defects.

An account debtor may face another problem if its obligation becomes due while the account debtor is awaiting reasonable proof of the assignment that it has requested from the assignee. This section does not excuse the account debtor from timely compliance with its obligations. Consequently, an account debtor that has received a notification of assignment and who has requested reasonable proof of the assignment may discharge its obligation by paying the assignor at the time (or even earlier if reasonably necessary to avoid risk of default) when a payment is due, even if the account debtor has not yet received a response to its request for proof. On the other hand, after requesting reasonable proof of the assignment, an account debtor may not discharge its obligation by paying the assignor substantially in advance of the time that the payment is due unless the assignee has failed to provide the proof seasonably.

5. **Contractual Restrictions on Assignment.** Former section 9-318(4) rendered ineffective an agreement between an account debtor and an assignor which prohibited assignment of an account (whether outright or to secure an obligation) or prohibited a security assignment of a general intangible for the payment of money due or to become due. Subsection (d) essentially follows former section 9-318(4), but expands the rule of free assignability to chattel paper (subject to sections 2A-303 and 9-407) and promissory notes and explicitly overrides both restrictions and prohibitions of assignment. The policies underlying the ineffectiveness of contractual restrictions under this section build on common-law developments that essentially have eliminated legal restrictions on assignments of rights to payment as security and other assignments of rights to payment such as accounts and chattel paper. Any that might linger for accounts and chattel paper are addressed by new subsection (f). See comment 6.

Former section 9-318(4) did not apply to a sale of a payment intangible (as described in the former provision, "a general intangible for money due or to become due") but did apply to an assignment of a payment intangible for security. Subsection (e) continues this approach and also makes subsection (d) inapplicable to sales of promissory notes. Section 9-408 addresses anti-assignment clauses with respect to sales of payment intangibles and promissory notes.

Like former section 9-318(4), subsection (d) provides that anti-assignment clauses are "ineffective." The quoted term means that the clause is of no effect whatsoever; the clause does not prevent the assignment from taking effect between the parties and the prohibited assignment does not constitute a default under the agreement between the account debtor and assignor. However, subsection (d) does not override terms that do not directly prohibit, restrict, or require consent to an assignment but which might, nonetheless, present a practical impairment of the assignment. Properly read, however, subsection (d) reaches only covenants that prohibit, restrict, or require consents to assignments; it does not override all terms that might "impair" an assignment in fact.

Example: Buyer enters into an agreement with Seller to buy equipment that Seller is to manufacture according to Buyer's specifications. Buyer agrees to make a series of prepayments during the construction process. In return, Seller agrees to set aside the prepaid funds in a special account and to use the funds solely for the manufacture of the designated equipment. Seller also agrees that it will not assign any of its rights under the sale agreement with Buyer. Nevertheless, Seller grants to Secured Party a security interest in its accounts. Seller's anti-assignment agreement is ineffective under subsection (d); its agreement concerning the use of prepaid funds, which is not a restriction or prohibition on assignment, is not. However, if Secured Party notifies Buyer to make all future payments directly to Secured Party, Buyer will be obliged to do so under subsection (a) if it wishes the payments to discharge its obligation. Unless Secured Party releases the funds to Seller so that Seller can comply with its use-of-funds covenant, Seller will be in breach of that covenant.

In the example, there appears to be a plausible business purpose for the use-of-funds covenant. However, a court may conclude that a covenant with no business purpose other than imposing an impediment to an assignment actually is a direct restriction that is rendered ineffective by subsection (d).

6. **Legal Restrictions on Assignment.** Former section 9-318(4), like subsection (d) of

this section, addressed only contractual restrictions on assignment. The former section was grounded on the reality that legal, as opposed to contractual, restrictions on assignments of rights to payment had largely disappeared. New subsection (f) codifies this principle of free assignability for accounts and chattel paper. For the most part the discussion of contractual restrictions in comment 5 applies as well to legal restrictions rendered ineffective under subsection (f).

7. **Multiple Assignments.** This section, like former section 9-318, is not a complete codification of the law of assignments of rights to payment. In particular, it is silent concerning many of the ramifications for an account debtor in cases of multiple assignments of the same right. For example, an assignor might assign the same receivable to multiple assignees (which assignments could be either inadvertent or wrongful). Or, the assignor could assign the receivable to assignee-1, which then might reassign it to assignee-2, and so forth. The rights and duties of an account debtor in the face of multiple assignments and in other circumstances not resolved in the statutory text are left to the common-law rules. See, e.g., Restatement (2d), Contracts sections 338(3) and 339. The failure of former article 9 to codify these rules does not appear to have caused problems.

8. **Consumer Account Debtors.** Subsection (h) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

9. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (i) also is new. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law. Section 9-408 addresses contractual and legal restrictions on the assignment of a health-care-insurance receivable.

NORTH CAROLINA COMMENT

Subsection (i) is modified by adding the last sentence. Subsection (j) is rewritten.

§ 25-9-407. Restrictions on creation or enforcement of security interest in leasehold interest or in lessor's residual interest.

(a) Term restricting assignment generally ineffective. — Except as otherwise provided in subsection (b) of this section, a term in a lease agreement is ineffective to the extent that it:

(1) Prohibits, restricts, or requires the consent of a party to the lease to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease.

(b) Effectiveness of certain terms. — Except as otherwise provided in G.S. 25-2A-303(7), a term described in subdivision (a)(2) of this section is effective to the extent that there is:

(1) A transfer by the lessee of the lessee's right of possession or use of the goods in violation of the term; or

(2) A delegation of a material performance of either party to the lease contract in violation of the term.

(c) Security interest not material impairment. — The creation, attachment, perfection, or enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is not a transfer that materially impairs the lessee's prospect of obtaining return performance or materially changes the duty of or materially increases the burden or risk imposed on the lessee within the purview of G.S. 25-2A-303(4) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor. (1993, c. 463, s. 1; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Section 2A-303.

2. **Restrictions on Assignment Generally Ineffective.** Under subsection (a), as under former section 2A-303(3), a term in a lease agreement which prohibits or restricts the creation of a security interest generally is ineffective. This reflects the general policy of section 9-406(d) and former section 9-318(4). This section has been conformed in several respects to analogous provisions in sections 9-406, 9-408, and 9-409, including the substitution of "ineffective" for "not enforceable" and the substitution of "assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest" for "creation or enforcement of a security interest."

3. **Exceptions for Certain Transfers and Delegations.** Subsection (b) provides exceptions to the general ineffectiveness of restrictions under subsection (a). A term that otherwise is ineffective under subsection (a)(2) is effective to the extent that a lessee transfers its right to possession and use of goods or if either party delegates material performance of the lease contract in violation of the term. However, under subsection (c), as under former section 2A-303(3), a lessor's creation of a security interest in its interest in a lease contract or its residual interest in the leased goods is not a material impairment under section 2A-303(4) (former section 2A-303(5)), absent an actual delegation of the lessor's material performance. The terms of the lease contract determine whether the lessor, in fact, has any remaining obligations to perform. If it does, it is then necessary to determine whether there has been an actual delegation of "material performance." See section 2A-303, comments 3 and 4.

§ 25-9-408. Restrictions on assignment of promissory notes, health-care-insurance receivables, and certain general intangibles ineffective.

(a) Term restricting assignment generally ineffective. — Except as otherwise provided in subsection (b) of this section, a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) Would impair the creation, attachment, or perfection of a security interest; or

(2) Provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(b) Applicability of subsection (a) to sales of certain rights to payment. — Subsection (a) of this section applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note.

(c) Legal restrictions on assignment generally ineffective. — A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) Would impair the creation, attachment, or perfection of a security interest; or

(2) Provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach,

right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(d) Limitation on ineffectiveness under subsections (a) and (c). — To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (c) of this section would be effective under law other than this Article but is ineffective under subsection (a) or (c) of this section, the creation, attachment, or perfection of a security interest in the promissory note, health-care-insurance receivable, or general intangible:

(1) Is not enforceable against the person obligated on the promissory note or the account debtor;

(2) Does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;

(3) Does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;

(4) Does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable, or general intangible;

(5) Does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and

(6) Does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable, or general intangible.

(e) Section prevails over inconsistent law. — Except to the extent otherwise provided in subsection (f) of this section, this section prevails over any inconsistent provision of an existing or future statute, rule, or regulation of this State unless the provision is contained in a statute of this State, refers expressly to this section, and states that the provision prevails over this section.

(f) Inapplicability. — Subsection (c) of this section does not apply to an assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, a right the transfer of which is prohibited or restricted by any of the following statutes to the extent that the statute is inconsistent with subsection (c) of this section: North Carolina Structured Settlement Act (Article 44B of Chapter 1 of the General Statutes); North Carolina Crime Victims Compensation Act (Chapter 15B of the General Statutes); North Carolina Consumer Finance Act (Article 15 of Chapter 53 of the General Statutes); North Carolina Firemen's and Rescue Squad Workers' Pension Fund (Article 86 of Chapter 58 of the General Statutes); Employment Security Law (Chapter 96 of the General Statutes); North Carolina Workers' Compensation Fund Act (Article 1 of Chapter 97 of the General Statutes); and Programs of Public Assistance (Article 2 of Chapter 108A of the General Statutes). (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Free Assignability.** This section makes ineffective any attempt to restrict the assignment of a general intangible, health-care-insurance receivable, or promissory note, whether the restriction appears in the terms of a prom-

issory note or the agreement between an account debtor and a debtor (subsection (a)) or in a rule of law, including a statute or governmental rule or regulation (subsection (c)). This result allows the creation, attachment, and perfection of a security interest in a general intangible, such as an agreement for the nonexclusive license of software, as well as sales of certain receivables, such as a health-care-insurance receivable (which is an "account"), payment intangible, or promissory note, without giving rise to a default or breach by the assignor or from triggering a remedy of the account debtor or person obligated on a promissory note. This enhances the ability of certain debtors to obtain credit. On the other hand, subsection (d) protects the other party—the "account debtor" on a general intangible or the person obligated on a promissory note—from adverse effects arising from the security interest. It leaves the account debtor's or obligated person's rights and obligations unaffected in all material respects if a restriction rendered ineffective by subsection (a) or (c) would be effective under law other than article 9.

Example 1: A term of an agreement for the nonexclusive license of computer software prohibits the licensee from assigning any of its rights as licensee with respect to the software. The agreement also provides that an attempt to assign rights in violation of the restriction is a default entitling the licensor to terminate the license agreement. The licensee, as debtor, grants to a secured party a security interest in its rights under the license and in the computers in which it is installed. Under this section, the term prohibiting assignment and providing for a default upon an attempted assignment is ineffective to prevent the creation, attachment, or perfection of the security interest or entitle the licensor to terminate the license agreement. However, under subsection (d), the secured party (absent the licensor's agreement) is not entitled to enforce the license or to use, assign, or otherwise enjoy the benefits of the licensed software, and the licensor need not recognize (or pay any attention to) the secured party. Even if the secured party takes possession of the computers on the debtor's default, the debtor would remain free to remove the software from the computer, load it on another computer, and continue to use it, if the license so permits. If the debtor does not remove the software, other law may require the secured party to remove it before disposing of the computer. Disposition of the software with the computer could violate an effective prohibition on enforcement of the security interest. See subsection (d).

3. **Nature of Debtor's Interest.** Neither this section nor any other provision of this article determines whether a debtor has a property interest. The definition of the term "security interest" provides that it is an "interest in personal property." See section 1-201(37). Ordinarily, a debtor can create a security interest in collateral only if it has "rights in the collateral." See section 9-203(b). Other law determines whether a debtor has a property interest ("rights in the collateral") and the nature of that interest. For example, the nonexclusive license addressed in Example 1 may not create any property interest whatsoever in the intellectual property (e.g., copyright) that underlies the license and that effectively enables the licensor to grant the license. The debtor's property interest may be confined solely to its interest in the promises made by the licensor in the license agreement (e.g., a promise not to sue the debtor for its use of the software).

4. **Scope: Sales of Payment Intangibles and Other General Intangibles; Assignments Unaffected by this Section.** Subsections (a) and (c) render ineffective restrictions on assignments only "to the extent" that the assignments restrict the "creation, attachment, or perfection of a security interest," including sales of payment intangibles and promissory notes. This section does not render ineffective a restriction on an assignment that does not create a security interest. For example, if the debtor in comment 2, Example 1, purported to assign the license to another entity that would use the computer software itself, other law would govern the effectiveness of the anti-assignment provisions.

Subsection (a) applies to a security interest in payment intangibles only if the security interest arises out of sale of the payment intangibles. Contractual restrictions directed to security interests in payment intangibles which secure an obligation are subject to section 9-406(d). Subsection (a) also deals with sales of promissory notes which also create security interests. See section 9-109(a). Subsection (c) deals with all security interests in payment intangibles or promissory notes, whether or not arising out of a sale.

Subsection (a) does not render ineffective any term, and subsection (c) does not render ineffective any law, statute, or regulation, that restricts outright sales of general intangibles other than payment intangibles. They deal only with restrictions on security interests. The only sales of general intangibles that create security interests are sales of payment intangibles.

5. **Terminology: "Account Debtor"; "Person Obligated on a Promissory Note."** This section uses the term "account debtor" as it is defined in section 9-102. The term refers to the party, other than the debtor, to a general intangible, including a permit, license, franchise, or the like, and the person obligated on a health-care-insurance receivable, which is a type of account. The definition of "account debtor" does not limit the term to persons who are obligated

to pay under a general intangible. Rather, the term includes all persons who are obligated on a general intangible, including those who are obligated to render performance in exchange for payment. In some cases, e.g., the creation of a security interest in a franchisee's rights under a franchise agreement, the principal payment obligation may be owed by the debtor (franchisee) to the account debtor (franchisor). This section also refers to a "person obligated on a promissory note," inasmuch as those persons do not fall within the definition of "account debtor."

Example 2: A licensor and licensee enter into an agreement for the nonexclusive license of computer software. The licensee's interest in the license agreement is a general intangible. If the licensee grants to a secured party a security interest in its rights under the license agreement, the licensee is the debtor and the licensor is the account debtor. On the other hand, if the licensor grants to a secured party a security interest in its right to payment (an account) under the license agreement, the licensor is the debtor and the licensee is the account debtor. (This section applies to the security interest in the general intangible but not to the security interest in the account, which is not a health-care-insurance receivable.)

6. **Effects on Account Debtors and Persons Obligated on Promissory Notes.** Subsections (a) and (c) affect two classes of persons. These subsections affect account debtors on general intangibles and health-care-insurance receivables and persons obligated on promissory notes. Subsection (c) also affects governmental entities that enact or determine rules of law. However, subsection (d) ensures that these affected persons are not affected adversely. That provision removes any burdens or adverse effects on these persons for which any rational basis could exist to restrict the effectiveness of an assignment or to exercise any remedies. For this reason, the effects of subsections (a) and (c) are immaterial insofar as those persons are concerned.

Subsection (a) does not override terms that do not directly prohibit, restrict, or require consent to an assignment but which might, nonetheless, present a practical impairment of the assignment. Properly read, however, this section, like section 9-406(d), reaches only covenants that prohibit, restrict, or require consents to assignments; it does not override all terms that might "impair" an assignment in fact.

Example 3: A licensor and licensee enter into an agreement for the nonexclusive license of valuable business software. The license agreement includes terms (i) prohibiting the licensee from assigning its rights under the license, (ii) prohibiting the licensee from disclosing to anyone certain information relating to the software and the licensor, and (iii) deeming prohibited assignments and prohibited disclosures to be defaults. The licensee wishes to obtain financing and, in exchange, is willing to grant a security interest in its rights under the license agreement. The secured party, reasonably, refuses to extend credit unless the licensee discloses the information that it is prohibited from disclosing under the license agreement. The secured party cannot determine the value of the proposed collateral in the absence of this information. Under this section, the terms of the license prohibiting the assignment (grant of the security interest) and making the assignment a default are ineffective. However, the nondisclosure covenant is not a term that prohibits the assignment or creation of a security interest in the license. Consequently, the nondisclosure term is enforceable even though the practical effect is to restrict the licensee's ability to use its rights under the license agreement as collateral.

The nondisclosure term also would be effective in the factual setting of comment 2, Example 1. If the secured party's possession of the computers loaded with software would put it in a position to discover confidential information that the debtor was prohibited from disclosing, the licensor should be entitled to enforce its rights against the secured party. Moreover, the licensor could have required the debtor to obtain the secured party's agreement that (i) it would immediately return all copies of software loaded on the computers and that (ii) it would not examine or otherwise acquire any information contained in the software. This section does not prevent an account debtor from protecting by agreement its independent interests that are unrelated to the "creation, attachment, or perfection" of a security interest. In Example 1, moreover, the secured party is not in possession of copies of software by virtue of its security interest or in connection with enforcing its security interest in the debtor's license of the software. Its possession is incidental to its possession of the computers, in which it has a security interest. Enforcing against the secured party a restriction relating to the software in no way interferes with its security interest in the computers.

7. **Effect in Assignor's Bankruptcy.** This section could have a substantial effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code section 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the postpetition property constitutes proceeds of prepetition collateral.

Example 4: A debtor is the owner of a cable television franchise that, under applicable law, cannot be assigned without the consent of the municipal franchisor. A lender wishes to extend credit to the debtor, provided that the credit is secured by the debtor's "going business" value. To secure the loan, the debtor grants a security interest in all its existing and after-acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. If other law were given effect, the security interest in the franchise would not attach; and if the debtor were to enter bankruptcy and sell the business, the secured party would receive but a fraction of the business's value. Under this section, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise while a bankruptcy is pending. However, this section would protect the interests of the municipality by preventing the secured party from enforcing its security interest to the detriment of the municipality.

8. **Effect Outside of Bankruptcy.** The principal effects of this section will take place outside of bankruptcy. Compared to the relatively few debtors that enter bankruptcy, there are many more that do not. By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit. For purposes of determining whether to extend credit, under some circumstances a secured party may ascribe value to the collateral to which its security interest has attached, even if this section precludes the secured party from enforcing the security interest without the agreement of the account debtor or person obligated on the promissory note. This may be the case where the secured party sees a likelihood of obtaining that agreement in the future. This may also be the case where the secured party anticipates that the collateral will give rise to a type of proceeds as to which this section would not apply.

Example 5: Under the facts of Example 4, the debtor does not enter bankruptcy. Perhaps in exchange for a fee, the municipality agrees that the debtor may transfer the franchise to a buyer. As consideration for the transfer, the debtor receives from the buyer its check for part of the purchase price and its promissory note for the balance. The security interest attaches to the check and promissory note as proceeds. See section 9-315(a)(1)(B). This section does not apply to the security interest in the check, which is not a promissory note, health-care-insurance receivable, or general intangible. Nor does it apply to the security interest in the promissory note, inasmuch as it was not sold to the secured party.

9. **Contrary Federal Law.** This section does not override federal law to the contrary. However, it does reflect an important policy judgment that should provide a template for future federal law reforms.

NORTH CAROLINA COMMENT

Subsection (e) is rewritten. Subsection (f) has no counterpart in the uniform text.

§ 25-9-409. Restrictions on assignment of letter-of-credit rights ineffective.

(a) Term or law restricting assignment generally ineffective. — A term in a letter of credit or a rule of law, statute, regulation, custom, or practice applicable to the letter of credit which prohibits, restricts, or requires the consent of an applicant, issuer, or nominated person to a beneficiary's assignment of or creation of a security interest in a letter-of-credit right is ineffective to the extent that the term or rule of law, statute, regulation, custom, or practice:

(1) Would impair the creation, attachment, or perfection of a security interest in the letter-of-credit right; or

(2) Provides that the assignment or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the letter-of-credit right.

(b) Limitation on ineffectiveness under subsection (a). — To the extent that a term in a letter of credit is ineffective under subsection (a) of this section but would be effective under law other than this Article or a custom or practice applicable to the letter of credit, to the transfer of a right to draw or otherwise demand performance under the letter of credit, or to the assignment of a right to proceeds of the letter of credit, the creation, attachment, or perfection of a security interest in the letter-of-credit right:

(1) Is not enforceable against the applicant, issuer, nominated person, or transferee beneficiary;

(2) Imposes no duties or obligations on the applicant, issuer, nominated person, or transferee beneficiary; and

(3) Does not require the applicant, issuer, nominated person, or transferee beneficiary to recognize the security interest, pay or render performance to the secured party, or accept payment or other performance from the secured party. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Purpose and Relevance.** This section, patterned on section 9-408, limits the effectiveness of attempts to restrict the creation, attachment, or perfection of a security interest in letter-of-credit rights, whether the restriction appears in the letter of credit or a rule of law, custom, or practice applicable to the letter of credit. It protects the creation, attachment, and perfection of a security interest while preventing these events from giving rise to a default or breach by the assignor or from triggering a remedy or defense of the issuer or other person obligated on a letter of credit. Letter-of-credit rights are a type of supporting obligation. See section 9-102. Under sections 9-203 and 9-308, a security interest in a supporting obligation attaches and is perfected automatically if the security interest in the supported obligation attaches and is perfected. See section 9-107, comment 5. The automatic attachment and perfection under article 9 would be anomalous or misleading if, under other law (e.g., article 5), a restriction on transfer or assignment were effective to block attachment and perfection.

3. **Relationship to Letter-of-Credit Law.** Although restrictions on an assignment of a letter of credit are ineffective to prevent creation, attachment, and perfection of a security interest, subsection (b) protects the issuer and other parties from any adverse effects of the security interest by preserving letter-of-credit law and practice that limits the right of a beneficiary to transfer its right to draw or otherwise demand performance (section 5-112) and limits the obligation of an issuer or nominated person to recognize a beneficiary's assignment of letter-of-credit proceeds (section 5-114). Thus, this section's treatment of letter-of-credit rights differs from this article's treatment of instruments and investment property. Moreover, under section 9-109(c)(4), this article does not apply to the extent that the rights of a transferee beneficiary or nominated person are independent and superior under section 5-114, thereby preserving the "independence principle" of letter-of-credit law.

PART 5

FILING.

Subpart 1. Filing Office; Contents and Effectiveness of Financing Statement.

§ 25-9-501. Filing offices.

(a) Filing offices. — Except as otherwise provided in subsection (b) of this section, if the local law of this State governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is:

(1) The office designated for the filing or recording of a record of a mortgage on the related real property, if:

  a. The collateral is as-extracted collateral or timber to be cut; or

  b. The financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures; or

(2) The office of the Secretary of State, in all other cases, including a case in which the collateral is goods that are or are to become fixtures and the financing statement is not filed as a fixture filing.

(b) Filing office for transmitting utilities. — The office in which to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the Secretary of State. The financing statement also constitutes a fixture filing as to the collateral indicated in the financing statement which is or is to become fixtures. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, ss. 41, 42; 1989, c. 523, s. 3; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Derived from former section 9-401.

2. **Where to File.** Subsection (a) indicates where in a given state a financing statement is to be filed. Former article 9 afforded each state three alternative approaches, depending on the extent to which the state desires central filing (usually with the Secretary of State), local filing (usually with a county office), or both. As comment 1 to former section 9-401 observed, "The principal advantage of state-wide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly." Local filing increases the net costs of secured transactions also by increasing uncertainty and the number of required filings. Any benefit that local filing may have had in the 1950's is now insubstantial. Accordingly, this article dictates central filing for most situations, while retaining local filing for real-estate-related collateral and special filing provisions for transmitting utilities.

3. **Minerals and Timber.** Under subsection (a)(1), a filing in the office where a record of a mortgage on the related real property would be filed will perfect a security interest in as-extracted collateral. Inasmuch as the security interest does not attach until extraction, the filing continues to be effective after extraction. A different result occurs with respect to timber to be cut, however. Unlike as-extracted collateral, standing timber may be goods before it is cut. See section 9-102 (defining "goods"). Once cut, however, it is no longer timber to be cut, and the filing in the real-property-mortgage office ceases to be effective. The timber then becomes ordinary goods, and filing in the office specified in subsection (a)(2) is necessary for perfection. Note also that after the timber is cut the law of the debtor's location, not the location of the timber, governs perfection under section 9-301.

4. **Fixtures.** There are two ways in which a secured party may file a financing statement to perfect a security interest in goods that are or are to become fixtures. It may file in the article 9 records, as with most other goods. See subsection (a)(2). Or it may file the financing statement as a "fixture filing," defined in section 9-102, in the office in which a record of a mortgage on the related real property would be filed. See subsection(a)(1)(B).

5. **Transmitting Utilities.** The usual filing rules do not apply well for a transmitting utility (defined in section 9-102). Many pre-UCC statutes provided special filing rules for railroads and in some cases for other public utilities, to avoid the requirements for filing with legal descriptions in every county in which such debtors had property. Former section 9-401(5) recreated and broadened these provisions, and subsection (b) follows this approach. The nature of the debtor will inform persons searching the record as to where to make a search.

Legal Periodicals. — For survey of 1976 case law on commercial law, see 55 N.C.L. Rev. 943 (1977).

For note on consignments and the consignor's duty to satisfy public notice requirements, see 13 Wake Forest L. Rev. 507 (1977).

For article, "Future Advances and Title Insurance Coverage," see 15 Wake Forest L. Rev. 329 (1979).

For 1984 survey, "The Application of the North Carolina Motor Vehicle Act and the Uniform Commercial Code to the Sale of Motor Vehicles by Consignment," see 63 N.C.L. Rev. 1105 (1985).

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

For article, "Certainty, Efficiency, and Realism: Rights in Collateral Under Article 9 of the Uniform Commercial Code," see 73 N.C.L. Rev. 115 (1994).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169, and/or under provisions in effect prior to adoption of the Uniform Commercial Code.*

The requirement of perfection of security interests is relevant only to third-party priority claims and not to disputes between the secured party and the debtor. Mazda Motors of Am., Inc. v. Southwestern Motors, Inc., 36 N.C. App. 1, 243 S.E.2d 793 (1978), aff'd in part, rev'd in part on other grounds, 296 N.C. 357, 250 S.E.2d 250 (1979).

Dual Filing Required for Farm Goods. — In order to perfect a security interest in farm products, crops, and equipment used in farming operations from subsequently acquired rights of third parties, the secured party must file a financing statement in the county of the debtor's residence and also in the county where the land on which the crops are growing, or are to be grown, is located. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Where financing statements were not filed in either the office of the Secretary of State or the office of the Register of Deeds in the county of the debtor's place of business, with the result that no security interest in debtor's partnership interest was perfected prior to the commencement of his Chapter 7 bankruptcy case, even if the deed of trust had been intended to create a security interest in debtor's partnership interest, it would be avoidable by the trustee and ineffective. Magers v. Thomas (In re Vannoy), 176 Bankr. 758 (Bankr. M.D.N.C. 1994).

This article adopts a system of notice filing. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Sample Form. — Former G.S. 25-9-402(3) set out a form which, if substantially followed, would comply with the requirements for a financing statement. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

OPINIONS OF ATTORNEY GENERAL

Perfection of Security Interest in Motor Vehicle. — See opinion of Attorney General to Mr. Eric L. Gooch, Director, Sales and Use Tax Division, N.C. Department of Revenue, 40 N.C.A.G. 446 (1969), rendered prior to 2000 revision of Article 9.

§ 25-9-502. Contents of financing statement; record of mortgage as financing statement; time of filing financing statement.

(a) Sufficiency of financing statement. — Subject to subsection (b) of this section, a financing statement is sufficient only if it:

(1) Provides the name of the debtor;
(2) Provides the name of the secured party or a representative of the secured party; and
(3) Indicates the collateral covered by the financing statement.

(b) Real-property-related financing statements. — Except as otherwise provided in G.S. 25-9-501(b), to be sufficient, a financing statement that covers as-extracted collateral or timber to be cut, or which is filed as a fixture filing and covers goods that are or are to become fixtures, must satisfy subsection (a) of this section and also:

(1) Indicate that it covers this type of collateral;
(2) Indicate that it is to be filed in the real property records;
(3) Provide a description of the real property to which the collateral is related; and

(4) If the debtor does not have an interest of record in the real property, provide the name of a record owner.

(c) Record of mortgage as financing statement. — A record of a mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if:

(1) The record indicates the goods or accounts that it covers;

(2) The goods are or are to become fixtures related to the real property described in the record or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut;

(3) The record satisfies the requirements for a financing statement in this section other than an indication that it is to be filed in the real property records; and

(4) The record is duly recorded.

(d) Filing before security agreement or attachment. — A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former section 9-402(1), (5), (6).

2. **"Notice Filing."** This section adopts the system of "notice filing." What is required to be filed is not, as under pre-UCC chattel mortgage and conditional sales acts, the security agreement itself, but only a simple record providing a limited amount of information (financing statement). The financing statement may be filed before the security interest attaches or thereafter. See subsection (d). See also section 9-308(a) (contemplating situations in which a financing statement is filed before a security interest attaches).

The notice itself indicates merely that a person may have a security interest in the collateral indicated. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs. Section 9-210 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure. However, in many cases, information may be forthcoming without the need to resort to the formalities of that section.

Notice filing has proved to be of great use in financing transactions involving inventory, accounts, and chattel paper, because it obviates the necessity of refiling on each of a series of transactions in a continuing arrangement under which the collateral changes from day to day. However, even in the case of filings that do not necessarily involve a series of transactions (e.g., a loan secured by a single item of equipment), a financing statement is effective to encompass transactions under a security agreement not in existence and not contemplated at the time the notice was filed, if the indication of collateral in the financing statement is sufficient to cover the collateral concerned. Similarly, a financing statement is effective to cover after-acquired property of the type indicated and to perfect with respect to future advances under security agreements, regardless of whether after-acquired property or future advances are mentioned in the financing statement and even if not in the contemplation of the parties at the time the financing statement was authorized to be filed.

3. **Debtor's Signature; Required Authorization.** Subsection (a) sets forth the simple formal requirements for an effective financing statement. These requirements are: (1) The debtor's name; (2) the name of a secured party or representative of the secured party; and (3) an indication of the collateral.

Whereas former section 9-402(1) required the debtor's signature to appear on a financing statement, this article contains no signature requirement. The elimination of the signature requirement facilitates paperless filing. (However, as PEB Commentary No. 15 indicates, a paperless financing statement was sufficient under former article 9.) Elimination of the signature requirement also makes the exceptions provided by former section 9-402(2) unnecessary.

The fact that this article does not require that an authenticating symbol be contained in the public record does not mean that all filings are authorized. Rather, section 9-509(a) entitles a person to file an initial financing statement, an amendment that adds collateral, or an amendment that adds a debtor only if the debtor authorizes the filing, and section 9-509(d) entitles a person other than the debtor to file a termination statement only if the secured party of record authorizes the filing. Of course, a filing has legal effect only to the extent it is authorized. See section 9-510.

Law other than this article, including the law with respect to ratification of past acts, generally determines whether a person has the requisite authority to file a record under this article. See sections 1-103 and 9-509, Comment 3. However, under section 9-509(b), the debtor's authentication of (or becoming bound by) a security agreement ipso facto constitutes the debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization.

Section 9-625 provides a remedy for unauthorized filings. Making an unauthorized filing also may give rise to civil or criminal liability under other law. In addition, this article contains provisions that assist in the discovery of unauthorized filings and the amelioration of their practical effect. For example, section 9-518 provides a procedure whereby a person may add to the public record a statement to the effect that a financing statement indexed under the person's name was wrongfully filed, and section 9-509(d) entitles any person to file a termination statement if the secured party of record fails to comply with its obligation to file or send one to the debtor, the debtor authorizes the filing, and the termination statement so indicates. However, the filing office is neither obligated nor permitted to inquire into issues of authorization. See section 9-520(a).

4. **Certain Other Requirements.** Subsection (a) deletes other provisions of former section 9-402(1) because they seem unwise (real-property description for financing statements covering crops), unnecessary (adequacy of copies of financing statements), or both (copy of security agreement as financing statement). In addition, the filing office must reject a financing statement lacking certain other information formerly required as a condition of perfection (e.g., an address for the debtor or secured party). See sections 9-516(b) and 9-520(a). However, if the filing office accepts the record, it is effective nevertheless. See section 9-520(c).

5. **Real-Property-Related Filings.** Subsection (b) contains the requirements for financing statements filed as fixture filings and financing statements covering timber to be cut or minerals and minerals-related accounts constituting as-extracted collateral. A description of the related real property must be sufficient to reasonably identify it. See section 9-108. This formulation rejects the view that the real property description must be by metes and bounds, or otherwise conforming to traditional real-property practice in conveyancing, but, of course, the incorporation of such a description by reference to the recording data of a deed, mortgage, or other instrument containing the description should suffice under the most stringent standards. The proper test is that a description of real property must be sufficient so that the financing statement will fit into the real property search system and be found by a real property searcher. Under the optional language in subsection (b)(3), the test of adequacy of the description is whether it would be adequate in a record of a mortgage of the real property. As suggested in the legislative note, more detail may be required if there is a tract indexing system or a land registration system.

If the debtor does not have an interest of record in the real property, a real-property-related financing statement must show the name of a record owner, and section 9-519(d) requires the financing statement to be indexed in the name of that owner. This requirement also enables financing statements covering as-extracted collateral or timber to be cut and financing statements filed as fixture filings to fit into the real property search system.

6. **Record of Mortgage Effective as Financing Statement.** Subsection (c) explains when a record of a mortgage is effective as a financing statement filed as a fixture filing or to cover timber to be cut or as-extracted collateral. Use of the term "record of a mortgage" recognizes that in some systems the record actually filed is not the record pursuant to which a mortgage is created. Moreover, "mortgage" is defined in section 9-102 as an "interest in real property," not as the record that creates or evidences the mortgage or the record that is filed in the public recording systems. A record creating a mortgage may also create a security interest with respect to fixtures (or other goods) in conformity with this article. A single agreement creating a mortgage on real property and a security interest in chattels is common and useful for certain purposes. Under subsection (c), the recording of the record evidencing a mortgage (if it satisfies the requirements for a financing statement) constitutes the filing of a financing statement as to the fixtures (but not, of course, as to other goods). Section 9-515(g) makes the usual five-year maximum life for financing statements inapplicable to mortgages that operate as fixture filings under section 9-502(c). Such mortgages are effective for the duration of the real property recording.

Of course, if a combined mortgage covers chattels that are not fixtures, a regular financing statement filing is necessary with respect to the chattels, and subsection (c) is inapplicable. Likewise, a financing statement filed as a "fixture filing" is not effective to perfect a security interest in personal property other than fixtures.

In some cases it may be difficult to determine whether goods are or will become fixtures. Nothing in this part prohibits the filing of a "precautionary" fixture filing, which would provide protection in the event goods are determined to be fixtures. The fact of filing should not be a factor in the determining whether goods are fixtures. Cf. section 9-505(b).

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

The Code distinguishes between a security agreement and a financing statement. The security agreement is a writing which (1) creates or provides for a security interest; (2) contains a description of the collateral, plus a description of the land involved when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut; and (3) is signed by the debtor. The financing statement is a writing which contains (1) the signature and addresses of both the debtor and creditor and (2) a description of the collateral plus a description of the land involved when the financing statement covers crops growing or to be grown or goods which are or are to become fixtures. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

The purpose of a financing statement is to provide notice to third parties of the debtor-creditor relationship, and where the correct debtor was listed in the debtor box accompanied by the names of the individual partners, this identification met the statute's requirements. Mountain Farm Credit Serv. v. Purina Mills, Inc., 119 N.C. App. 508, 459 S.E.2d 75 (1995).

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

A financing statement does not ordinarily create a security interest; it merely gives notice that one is or may be claimed. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

A financing statement which does no more than meet requirements will not create a security interest in the debtor's property. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Purchase contract, read together with the financing statement, did not constitute a security agreement, as the financing statement did no more than meet statutory requirements. Crocker v. Delta Group, Inc., 125 N.C. App. 583, 481 S.E.2d 694 (1997).

A financing statement may double as a security agreement if it contains appropriate language which grants a security interest. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Although the Code contemplates the execution of two separate writings, it does not prohibit the combination of a security agreement and financing statement. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Where the financing statement contains language clearly manifesting the debtor's intent to grant, create, and provide for a security interest, bears his signature, and describes the obligation secured, the collateral subject to the security interest, and the land involved, the financing statement meets the requirements of an enforceable security agreement and serves the double purpose. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

If the financing statement contains the elements for a security agreement in addition to those for the financing statement, it would serve as the security agreement. The additional elements would be (1) something to indicate agreement; (2) a statement of the obligation or obligations secured; and (3) provision for or creation of the security interest. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Although the financing statement only needed to be a skeletonic statement that the parties intended to engage in future transactions, which might never be consummated, former G.S. 25-9-402(1) specifically provided that "a copy of the security agreement is sufficient as a financing statement" if it contained the required information and is signed by both parties. There was no sound reason why a financing statement may not also serve as a security agreement if it met the requirements of former G.S. 25-9-105(1)(h) and 25-9-203(1)(b). Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

A financing statement substantially

complying with statutory requirements of this section is effective, even though it contains minor errors which are not seriously misleading. E-B Grain Co. v. Denton, 73 N.C. App. 14, 325 S.E.2d 522, cert. denied, 313 N.C. 598, 330 S.E.2d 608 (1985).

Omission of the words "of North Carolina" in two spaces on an otherwise informative and adequate financing statement, which was attached to a valid security agreement, did not render the statement "seriously misleading." In re Environmental Aspecs, Inc., 235 Bankr. 378 (E.D.N.C. 1999).

A description of real estate is sufficient if the description permits identification by recourse to public records. E-B Grain Co. v. Denton, 73 N.C. App. 14, 325 S.E.2d 522, cert. denied, 313 N.C. 598, 330 S.E.2d 608 (1985).

Financing Statement Sufficient to Provide Security Interest. — Where the financing statement declared that it "covers the following type of collateral: (all crops now growing or to be planted on 5 specified farms) same securing note for advance money to produce crops for the year 1969," and the note contained the statement that it "is secured by Uniform Commercial Code financing statement of North Carolina," the financing statement and the note manifested defendant's intent to create in plaintiff a security interest in the described collateral and he did, in fact, provide for such interest when he stated that the crops described therein secured the note for money advanced to produce these crops. Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971).

Application of Definition of "Signed" in to Financing Statements. — In cases dealing with the debtor's signature on financing statements, the courts should apply the liberal definition of "signed" with caution. Provident Fin. Co. v. Beneficial Fin. Co., 36 N.C. App. 401, 245 S.E.2d 510, cert. denied, 295 N.C. 549, 248 S.E.2d 728 (1978).

Typed Name on Financing Statement Not Signature. — Where there is nothing whatsoever on the face of a financing statement to suggest that the debtor "adopted" the typed name as his signature, the debtor has not signed the financing statement and that financing statement is ineffective. Provident Fin. Co. v. Beneficial Fin. Co., 36 N.C. App. 401, 245 S.E.2d 510, cert. denied, 295 N.C. 549, 248 S.E.2d 728 (1978).

Effect of Absence of Debtor's Signature. — Creditor's financing statement was inadequate to establish a lien where the debtor did not sign the financing statement and the description of the collateral in that statement did not identify the assets; the "notice filing" theory would be construed as subordinate to the mandatory requirement that the debtor must sign the financing statement. In re Environmental Aspecs, Inc., 235 Bankr. 378 (E.D.N.C. 1999).

Lien May Not Be Circumvented by Use of Technical Defects in Record. — A trustee in bankruptcy shall not be allowed to circumvent a lien by use of technical defects in the record, especially where there is no showing that any creditor was misled to any extent. Stafford v. Admiral Credit Corp., 280 F. Supp. 818 (M.D.N.C. 1968), decided under former § 45-58.

Applied in Miller v. Van Dorn Demag Corp. (In re Asheboro Precision Plastics, Inc.), — Bankr. —, 2005 Bankr. LEXIS 1091 (Bankr. M.D.N.C. Mar. 1, 2005).

§ 25-9-503. Name of debtor and secured party.

(a) Sufficiency of debtor's name. — A financing statement sufficiently provides the name of the debtor:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized;

(2) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(3) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

a. Provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors; and

b. Indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust; and

(4) In other cases:

a. If the debtor has a name, only if it provides the individual or organizational name of the debtor; and
b. If the debtor does not have a name, only if it provides the names of the partners, members, associates, or other persons comprising the debtor.

(b) Additional debtor-related information. — A financing statement that provides the name of the debtor in accordance with subsection (a) of this section is not rendered ineffective by the absence of:

(1) A trade name or other name of the debtor; or
(2) Unless required under sub-subdivision (a)(4)b. of this section, names of partners, members, associates, or other persons comprising the debtor.

(c) Debtor's trade name insufficient. — A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.

(d) Representative capacity. — Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.

(e) Multiple debtors and secured parties. — A financing statement may provide the name of more than one debtor and the name of more than one secured party. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Subsections (a)(4)(A), (b), and (c) derive from former section 9-402(7); otherwise, new.

2. **Debtor's Name.** The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (a) explains what the debtor's name is for purposes of a financing statement. If the debtor is a "registered organization" (defined in section 9-102 so as to ordinarily include corporations, limited partnerships, and limited liability companies), then the debtor's name is the name shown on the public records of the debtor's "jurisdiction of organization" (also defined in section 9-102). Subsections (a)(2) and (a)(3) contain special rules for decedent's estates and common-law trusts. (Subsection (a)(1) applies to business trusts that are registered organizations.)

Subsection (a)(4)(A) essentially follows the first sentence of former section 9-402(7). Section 1-201(28) defines the term "organization," which appears in subsection (a)(4), very broadly, to include all legal and commercial entities as well as associations that lack the status of a legal entity. Thus, the term includes corporations, partnerships of all kinds, business trusts, limited liability companies, unincorporated associations, personal trusts, governments, and estates. If the organization has a name, that name is the correct name to put on a financing statement. If the organization does not have a name, then the financing statement should name the individuals or other entities who comprise the organization.

Together with subsections (b) and (c), subsection (a) reflects the view prevailing under former article 9 that the actual individual or organizational name of the debtor on a financing statement is both necessary and sufficient, whether or not the financing statement provides trade or other names of the debtor and, if the debtor has a name, whether or not the financing statement provides the names of the partners, members, or associates who comprise the debtor.

Note that, even if the name provided in an initial financing statement is correct, the filing office nevertheless must reject the financing statement if it does not identify an individual debtor's last name (e.g., if it is not clear whether the debtor's name is Perry Mason or Mason Perry). See section 9-516(b)(3)(C).

3. **Secured Party's Name.** New subsection (d) makes clear that when the secured party is a representative, a financing statement is sufficient if it names the secured party, whether or

not it indicates any representative capacity. Similarly, a financing statement that names a representative of the secured party is sufficient, even if it does not indicate the representative capacity.

Example: Debtor creates a security interest in favor of Bank X, Bank Y, and Bank Z, but not to their representative, the collateral agent (Bank A). The collateral agent is not itself a secured party. See section 9-102. Under sections 9-502(a) and 9-503(d), however, a financing statement is effective if it names as secured party Bank A and not the actual secured parties, even if it omits Bank A's representative capacity.

Each person whose name is provided in an initial financing statement as the name of the secured party or representative of the secured party is a secured party of record. See section 9-511.

4. **Multiple Names.** Subsection (e) makes explicit what is implicit under former article 9: A financing statement may provide the name of more than one debtor and secured party. See section 1-102(5)(a) (words in the singular include the plural). With respect to records relating to more than one debtor, see section 9-520(d). With respect to financing statements providing the name of more than one secured party, see sections 9-509(e) and 9-510(b).

CASE NOTES

***Editor's Note.** — The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Use of Two Different Names. — Where the debtor's legal name contained the word "seventeen," and on a UCC-1 that word was interchanged with "17," those who did business with the debtor would have to search both the numerical and alphabetical indices; therefore, such an error was not minor and the filing was defective. Hinson v. Centura Bank (In re Seventeen S. Garment Co.), 145 Bankr. 511 (E.D.N.C. 1992).

Trade Name Use Misleading. — Under revised UCC Article 9 and the underlying policy of simplifying financing statement searches, the creditor's use of the purported trade name, in place of debtor's legal name, rendered the financing statement seriously misleading and hence ineffective. As a consequence, the creditor's security interest could be avoided by the Chapter 7 trustee. Miller v. Van Dorn Demag Corp. (In re Asheboro Precision Plastics, Inc.), — Bankr. —, 2005 Bankr. LEXIS 1091 (Bankr. M.D.N.C. Mar. 1, 2005).

Filing was satisfactory under the former Uniform Trust Receipts Act where the defects in the filing were not such as to mislead a searcher of the record making reasonable inquiry. Stafford v. Admiral Credit Corp., 280 F. Supp. 818 (M.D.N.C. 1968).

§ 25-9-504. Indication of collateral.

A financing statement sufficiently indicates the collateral that it covers if the financing statement provides:

(1) A description of the collateral pursuant to G.S. 25-9-108; or

(2) An indication that the financing statement covers all assets or all personal property. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-402(1).

2. **Indication of Collateral.** To comply with section 9-502(a), a financing statement must "indicate" the collateral it covers. A financing statement sufficiently indicates collateral claimed to be covered by the financing statement if it satisfies the purpose of conditioning perfection on the filing of a financing statement, i.e., if it provides notice that a person may have a security interest in the collateral claimed. See Section 9-502, Comment 2. In particular, an indication of collateral that would have satisfied the requirements of former Section 9-402(1) (i.e., "a statement indicating the types, or describing the items, of collateral") suffices under Section 9-502(a). An indication may satisfy the requirements of Section 9-502(a), even if it would not have satisfied

the requirements of former Section 9-402(1).

This section provides two safe harbors. Under paragraph (1), a "description" of the collateral (as the term is explained in Section 9-108) suffices as an indication for purposes of the sufficiency of a financing statement.

Debtors sometimes create a security interest in all, or substantially all, of their assets. To accommodate this practice, paragraph (2) expands the class of sufficient collateral references to embrace "an indication that the financing statement covers all assets or all personal property." If the property in question belongs to the debtor and is personal property, any searcher will know that the property is covered by the financing statement. Of course, regardless of its breadth, a financing statement has no effect with respect to property indicated but to which a security interest has not attached. Note that a broad statement of this kind (e.g., "all debtor's personal property") would not be a sufficient "description" for purposes of a security agreement. See sections 9-108 and 9-203(b)(3)(A). It follows that a somewhat narrower description than "all assets," e.g., "all assets other than automobiles," is sufficient for purposes of this section, even if it does not suffice for purposes of a security agreement.

§ 25-9-505. Filing and compliance with other statutes and treaties for consignments, leases, other bailments, and other transactions.

(a) Use of terms other than "debtor" and "secured party." — A consignor, lessor, or other bailor of goods, a licensor, or a buyer of a payment intangible or promissory note may file a financing statement, or may comply with a statute or treaty described in G.S. 25-9-311(a), using the terms "consignor", "consignee", "lessor", "lessee", "bailor", "bailee", "licensor", "licensee", "owner", "registered owner", "buyer", "seller", or words of similar import, instead of the terms "secured party" and "debtor".

(b) Effect of financing statement under subsection (a). — This Part applies to the filing of a financing statement under subsection (a) of this section and, as appropriate, to compliance that is equivalent to filing a financing statement under G.S. 25-9-311(b), but the filing or compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner, or buyer which attaches to the collateral is perfected by the filing or compliance. (1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-408.

2. **Precautionary Filing.** Occasionally, doubts arise concerning whether a transaction creates a relationship to which this article or its filing provisions apply. For example, questions may arise over whether a "lease" of equipment in fact creates a security interest or whether the "sale" of payment intangibles in fact secures an obligation, thereby requiring action to perfect the security interest. This section, which derives from former section 9-408, affords the option of filing of a financing statement with appropriate changes of terminology but without affecting the substantive question of classification of the transaction.

3. **Changes from Former Section 9-408.** This section expands the rule of section 9-408 to embrace more generally other bailments and transactions, as well as sales transactions, primarily sales of payment intangibles and promissory notes. It provides the same benefits for compliance with a statute or treaty described in section 9-311(a) that former section 9-408 provided for filing, in connection with the use of terms such as "lessor," "consignor," etc. The references to "owner" and "registered owner" are intended to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security interest. Although this section provides that the security interest is perfected, the relevant certificate of title statute may expressly provide to the contrary or may be ambiguous. If so, it may be necessary or advisable to amend the certificate of title statute to ensure that perfection of the security interest will be achieved.

As does section 1-201, former article 9 referred to transactions, including leases and consignments, "intended as security." This misleading phrase created the erroneous impression that the parties to a transaction can dictate how the law will classify it (e.g., as a bailment or as a security interest) and thus affect the rights of third parties. This article deletes the phrase wherever it appears. Subsection (b) expresses the principle more precisely by referring to a security interest that "secures an obligation."

4. **Consignments.** Although a "true" consignment is a bailment, the filing and priority provisions of former article 9 applied to "true" consignments. See former sections 2-326(3) and 9-114. A consignment "intended as security" created a security interest that was in all respects subject to former article 9. This article subsumes most true consignments under the rubric of "security interest." See sections 1-201(37) (definition of "security interest"), 9-102 (definition of "consignment"), and 9-109(a)(4). Nevertheless, it maintains the distinction between a (true) "consignment," as to which only certain aspects of article 9 apply, and a so-called consignment that actually "secures an obligation," to which article 9 applies in full. The revisions to this section reflect the change in terminology.

Legal Periodicals. — For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

§ 25-9-506. Effect of errors or omissions.

(a) Minor errors and omissions. — A financing statement substantially satisfying the requirements of this Part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

(b) Financing statement seriously misleading. — Except as otherwise provided in subsection (c) of this section, a financing statement that fails sufficiently to provide the name of the debtor in accordance with G.S. 25-9-503(a) is seriously misleading.

(c) Financing statement not seriously misleading. — If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with G.S. 25-9-503(a), the name provided does not make the financing statement seriously misleading.

(d) "Debtor's correct name." — For purposes of G.S. 25-9-508(b), the "debtor's correct name" in subsection (c) of this section means the correct name of the new debtor. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-402(8).

2. **Errors.** Like former section 9-402(8), subsection (a) is in line with the policy of this article to simplify formal requisites and filing requirements. It is designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts occasionally have indulged themselves. Subsection (a) provides the standard applicable to indications of collateral. Subsections (b) and (c), which are new, concern the effectiveness of financing statements in which the debtor's name is incorrect. Subsection (b) contains the general rule: A financing statement that fails sufficiently to provide the debtor's name in accordance with section 9-503(a) is seriously misleading as a matter of law. Subsection (c) provides an exception: If the financing statement nevertheless would be discovered in a search under the debtor's correct name, using the filing office's standard search logic, if any, then as a matter of law the incorrect name does not make the financing statement seriously misleading. A financing statement that is seriously misleading under this section is ineffective even if it is disclosed by (i) using a search

logic other than that of the filing office to search the official records, or (ii) using the filing office's standard search logic to search a data base other than that of the filing office.

In addition to requiring the debtor's name and an indication of the collateral, section 9-502(a) requires a financing statement to provide the name of the secured party or a representative of the secured party. Inasmuch as searches are not conducted under the secured party's name, and no filing is needed to continue the perfected status of security interest after it is assigned, an error in the name of the secured party or its representative will not be seriously misleading. However, in an appropriate case, an error of this kind may give rise to an estoppel in favor of a particular holder of a conflicting claim to the collateral. See section 1-103.

3. **New Debtors.** Subsection (d) provides that, in determining the extent to which a financing statement naming an original debtor is effective against a new debtor, the sufficiency of the financing statement should be tested against the name of the new debtor.

CASE NOTES

Applied in Miller v. Van Dorn Demag Corp. (In re Asheboro Precision Plastics, Inc.), — Bankr. —, 2005 Bankr. LEXIS 1091 (Bankr. M.D.N.C. Mar. 1, 2005).

§ 25-9-507. Effect of certain events on effectiveness of financing statement.

(a) Disposition. — A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest or agricultural lien continues, even if the secured party knows of or consents to the disposition.

(b) Information becoming seriously misleading. — Except as otherwise provided in subsection (c) of this section and G.S. 25-9-508, a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under G.S. 25-9-506.

(c) Change in debtor's name. — If a debtor so changes its name that a filed financing statement becomes seriously misleading under G.S. 25-9-506:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change; and

(2) The financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the change. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Former section 9-402(7).

2. **Scope of Section.** This section deals with situations in which the information in a proper financing statement becomes inaccurate after the financing statement is filed. Compare section 9-338, which deals with situations in which a financing statement contains a particular kind of information concerning the debtor (i.e., the information described in section 9-516(b)(5)) that is incorrect at the time it is filed.

3. **Post-Filing Disposition of Collateral.** Under subsection (a), a financing statement remains effective even if the collateral is sold or otherwise disposed of. This subsection clarifies the third sentence of former section 9-402(7) by

providing that a financing statement remains effective following the disposition of collateral only when the security interest or agricultural lien continues in that collateral. This result is consistent with the conclusion of PEB Commentary No. 3. Normally, a security interest does continue after disposition of the collateral. See section 9-315(a)(1). Law other than this article determines whether an agricultural lien survives disposition of the collateral.

As a consequence of the disposition, the collateral may be owned by a person other than the debtor against whom the financing statement was filed. Under subsection (a), the secured party remains perfected even if it does not correct the public record. For this reason, any person seeking to determine whether a debtor owns collateral free of security interests must inquire as to the debtor's source of title and, if circumstances seem to require it, search in the name of a former owner. Subsection (a) addresses only the sufficiency of the information contained in the financing statement. A disposition of collateral may result in loss of perfection for other reasons. See section 9-316.

Example: Dee Corp. is an Illinois corporation. It creates a security interest in its equipment in favor of Secured Party. Secured Party files a proper financing statement in Illinois. Dee Corp. sells an item of equipment to Bee Corp., a Pennsylvania corporation, subject to the security interest. The security interest continues, see section 9-315(a)(1), and remains perfected, see section 9-507(a), notwithstanding that the financing statement is filed under "D" (for Dee Corp.) and not under "B." However, because Bee Corp. is located in Pennsylvania and not Illinois, see section 9-307, unless Secured Party perfects under Pennsylvania law within one year after the transfer, its security interest will become unperfected and will be deemed to have been unperfected against purchasers of the collateral. See section 9-316.

4. **Other Post-Filing Changes.** Subsection (b) provides that, as a general matter, post-filing changes that render a financing statement inaccurate and seriously misleading have no effect on a financing statement. The financing statement remains effective. It is subject to two exceptions: Sections 9-507(c) and 9-508. Section 9-508 addresses the effectiveness of a financing statement filed against an original debtor when a new debtor becomes bound by the original debtor's security agreement. It is discussed in the comments to that section. Section 9-507(c) addresses a "pure" change of the debtor's name, i.e., a change that does not implicate a new debtor. It clarifies former section 9-402(7). If a name change renders a filed financing statement seriously misleading, the financing statement, unless amended to provide the debtor's new correct name, is effective only to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change. If an amendment that provides the new correct name is filed within four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change. If an amendment that provides the new correct name is filed more than four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change, but only from the time of the filing of the amendment.

§ 25-9-508. Effectiveness of financing statement if new debtor becomes bound by security agreement.

(a) Financing statement naming original debtor. — Except as otherwise provided in this section, a filed financing statement naming an original debtor is effective to perfect a security interest in collateral in which a new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral.

(b) Financing statement becoming seriously misleading. — If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement that is effective under subsection (a) of this section to be seriously misleading under G.S. 25-9-506:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound under G.S. 25-9-203(d); and

(2) The financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound under G.S. 25-9-203(d) unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

(c) When section not applicable. — This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under G.S. 25-9-507(a). (1967, c. 562, s. 3; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **The Problem.** Section 9-203(d) and (e) and this section deal with situations where one party (the "new debtor") becomes bound as debtor by a security agreement entered into by another person (the "original debtor"). These situations often arise as a consequence of changes in business structure. For example, the original debtor may be an individual debtor who operates a business as a sole proprietorship and then incorporates it. Or, the original debtor may be a corporation that is merged into another corporation. Under both former article 9 and this article, collateral that is transferred in the course of the incorporation or merger normally would remain subject to a perfected security interest. See sections 9-315(a)(1) and 9-507(a). Former article 9 was less clear with respect to whether an after-acquired property clause in a security agreement signed by the original debtor would be effective to create a security interest in property acquired by the new corporation or the merger survivor and, if so, whether a financing statement filed against the original debtor would be effective to perfect the security interest. This section and sections 9-203(d) and (e) are a clarification.

3. **How New Debtor Becomes Bound.** Normally, a security interest is unenforceable unless the debtor has authenticated a security agreement describing the collateral. See section 9-203(b). New section 9-203(e) creates an exception, under which a security agreement entered into by one person is effective with respect to the property of another. This exception comes into play if a "new debtor" becomes bound as debtor by a security agreement entered into by another person (the "original debtor"). (The quoted terms are defined in section 9-102.) If a new debtor does become bound, then the security agreement entered into by the original debtor satisfies the security-agreement requirement of section 9-203(b)(3) as to existing or after-acquired property of the new debtor to the extent the property is described in the security agreement. In that case, no other agreement is necessary to make a security interest enforceable in that property. See section 9-203(e).

Section 9-203(d) explains when a new debtor becomes bound by an original debtor's security agreement. Under section 9-203(d)(1), a new debtor becomes bound as debtor if, by contract or operation of other law, the security agreement becomes effective to create a security interest in the new debtor's property. For example, if the applicable corporate law of mergers provides that when A Corp merges into B Corp, B Corp becomes a debtor under A Corp's security agreement, then B Corp would become bound as debtor following such a merger. Similarly, B Corp would become bound as debtor if B Corp contractually assumes A's obligations under the security agreement.

Under certain circumstances, a new debtor becomes bound for purposes of this article even though it would not be bound under other law. Under section 9-203(d)(2), a new debtor becomes bound when, by contract or operation of other law, it (i) becomes obligated not only for the secured obligation but also generally for the obligations of the original debtor and (ii) acquires or succeeds to substantially all the assets of the original debtor. For example, some corporate laws provide that, when two corporations merge, the surviving corporation succeeds to the assets of its merger partner and "has all liabilities" of both corporations. In the case where, for example, A Corp merges into B Corp (and A Corp ceases to exist), some people have questioned whether A Corp's grant of a security interest in its existing and after-acquired property becomes a "liability" of B Corp, such that B Corp's existing and after-acquired property becomes subject to a security interest in favor of A Corp's lender. Even if corporate law were to give a negative answer, under section 9-203(d)(2), B Corp would become bound for purposes of section 9-203(e) and this section. The "substantially all of the assets" requirement of section 9-203(d)(2) excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other nonsuccessorship doctrines. In most cases, it will exclude successors to the assets and liabilities of a division of a debtor.

4. **When Financing Statement Effective Against New Debtor.** Subsection (a) provides that a filing against the original debtor generally is effective to perfect a security interest in collateral that a new debtor has at the time it becomes bound by the original debtor's security agreement and collateral that it acquires after the new debtor becomes bound. Under subsection (b), however, if the filing against the original debtor is seriously misleading as to the new debtor's name, the filing is effective as to collateral acquired by the new debtor more

than four months after the new debtor becomes bound only if a person files during the four-month period an initial financing statement providing the name of the new debtor. Compare section 9-507(c) (four-month period of effectiveness with respect to collateral acquired by a debtor after the debtor changes its name). Moreover, if the original debtor and the new debtor are located in different jurisdictions, a filing against the original debtor would not be effective to perfect a security interest in collateral that the new debtor acquires or has acquired from a person other than the original debtor. See Example 5, Section 9-316, Comment 2.

5. **Transferred Collateral.** This section does not apply to collateral transferred by the original debtor to a new debtor. See subsection (c). Under those circumstances, the filing against the original debtor continues to be effective until it lapses or perfection is lost for another reason. See sections 9-316, 9-507(a).

6. **Priority.** Section 9-326 governs the priority contest between a secured creditor of the original debtor and a secured creditor of the new debtor.

§ 25-9-509. Persons entitled to file a record.

(a) Person entitled to file record. — A person may file an initial financing statement, amendment that adds collateral covered by a financing statement, or amendment that adds a debtor to a financing statement only if:

(1) The debtor authorizes the filing in an authenticated record or pursuant to subsection (b) or (c) of this section; or

(2) The person holds an agricultural lien that has become effective at the time of filing and the financing statement covers only collateral in which the person holds an agricultural lien.

(b) Security agreement as authorization. — By authenticating or becoming bound as debtor by a security agreement, a debtor or new debtor authorizes the filing of an initial financing statement, and an amendment, covering:

(1) The collateral described in the security agreement; and

(2) Property that becomes collateral under G.S. 25-9-315(a)(2), whether or not the security agreement expressly covers proceeds.

(c) Acquisition of collateral as authorization. — By acquiring collateral in which a security interest or agricultural lien continues under G.S. 25-9-315(a)(1), a debtor authorizes the filing of an initial financing statement, and an amendment, covering the collateral and property that becomes collateral under G.S. 25-9-315(a)(2).

(d) Person entitled to file certain amendments. — A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if:

(1) The secured party of record authorizes the filing; or

(2) The amendment is a termination statement for a financing statement as to which the secured party of record has failed to file or send a termination statement as required by G.S. 25-9-513(a) or (c), the debtor authorizes the filing, and the termination statement indicates that the debtor authorized it to be filed.

(e) Multiple secured parties of record. — If there is more than one secured party of record for a financing statement, each secured party of record may authorize the filing of an amendment under subsection (d) of this section. (1967, c. 562, s. 3; 1975, c. 862, s. 7; 2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** New.

2. **Scope and Approach of This Section.** This section collects in one place most of the rules determining whether a record may be filed. Section 9-510 explains the extent to which a filed record is effective. Under these sections, the identity of the person who effects a filing is immaterial. The filing scheme contemplated by this part does not contemplate that the identity of a "filer" will be a part of the searchable records. This is consistent with, and a necessary aspect of, eliminating signatures or other

evidence of authorization from the system. (Note that the 1972 amendments to this article eliminated the requirement that a financing statement contain the signature of the secured party.) As long as the appropriate person authorizes the filing, or, in the case of a termination statement, the debtor is entitled to the termination, it is insignificant whether the secured party or another person files any given record. The question of authorization is one for the court, not the filing office. However, a filing office may choose to employ authentication procedures in connection with electronic communications, e.g., to verify the identity of a filer who seeks to charge the filing fee.

3. **Unauthorized Filings.** Records filed in the filing office do not require signatures for their effectiveness. Subsection (a)(1) substitutes for the debtor's signature on a financing statement the requirement that the debtor authorize in an authenticated record the filing of an initial financing statement or an amendment that adds collateral. Also, under subsection (a)(1), if an amendment adds a debtor, the debtor who is added must authorize the amendment. A person who files an unauthorized record in violation of subsection (a)(1) is liable under section 9-625 for actual and statutory damages. Of course, a filed financing statement is ineffective to perfect a security interest if the filing is not authorized. See section 9-510(a). Law other than this article, including the law with respect to ratification of past acts, generally determines whether a person has the requisite authority to file a record under this section. See sections 1-103 and 9-502 comment 3. This Article applies to other issues, such as the priority of a security interest perfected by the filing of a financing statement.

4. ***Ipso Facto* Authorization.** Under subsection (b), the authentication of a security agreement ipso facto constitutes the debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization. Similarly, a new debtor's becoming bound by a security agreement ipso facto constitutes the new debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement by which the new debtor has become bound. And, under subsection (c), the acquisition of collateral in which a security interest continues after disposition under section 9-315(a)(1)(A) ipso facto constitutes an authorization to file an initial financing statement against the person who acquired the collateral. The authorization to file an initial financing statement also constitutes an authorization to file a record covering actual proceeds of the original collateral, even if the security agreement is silent as to proceeds.

Example 1: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory and accounts. The financing statement is authorized insofar as it covers inventory and unauthorized insofar as it covers accounts. (Note, however, that the financing statement will be effective to perfect a security interest in accounts constituting proceeds of the inventory to the same extent as a financing statement covering only inventory.)

Example 2: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory. Debtor sells some inventory, deposits the buyer's payment into a deposit account, and withdraws the funds to purchase equipment. As long as the equipment can be traced to the inventory, the security interest continues in the equipment. See section 9-315(a)(1)(B). However, because the equipment was acquired with cash proceeds, the financing statement becomes ineffective to perfect the security interest in the equipment on the 21st day after the security interest attaches to the equipment unless Secured Party continues perfection beyond the 20-day period by filing a financing statement against the equipment or amending the filed financing statement to cover equipment. See section 9-315(d). Debtor's authentication of the security agreement authorizes the filing of an initial financing statement or amendment covering the equipment, which is "property that becomes collateral under section 9-315(a)(1)(B)." See section 9-509(b)(2).

5. **Agricultural Liens.** Under subsection (a)(2), the holder of an agricultural lien may file a financing statement covering collateral subject to the lien without obtaining the debtor's authorization. Because the lien arises as matter of law, the debtor's consent is not required. A person who files an unauthorized record in violation of this subsection is liable under section 9-625(e) for a statutory penalty and damages.

6. **Amendments; Termination Statements Authorized by Debtor.** Most amendments may not be filed unless the secured party of record, as determined under section 9-511, authorizes the filing. See subsection (d)(1). However, under subsection (d)(2), the authorization of the secured party of record is not required for the filing of a termination statement if the secured party of record failed to send or file a termination statement as required by section 9-513, the debtor authorizes it to be filed, and the termination statement so indicates.

7. **Multiple Secured Parties of Record.** Subsection (e) deals with multiple secured parties of record. It permits each secured party of

record to authorize the filing of amendments. However, section 9-510(b) protects the rights and powers of one secured party of record from the effects of filings made by another secured party of record. See section 9-510, comment 3.

8. **Successor to Secured Party of Record.** A person may succeed to the powers of the secured party of record by operation of other law, e.g., the law of corporate mergers. In that case, the successor has the power to authorize filings within the meaning of this section.

§ 25-9-510. Effectiveness of filed record.

(a) Filed record effective if authorized. — A filed record is effective only to the extent that it was filed by a person that may file it under G.S. 25-9-509.

(b) Authorization by one secured party of record. — A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(c) Continuation statement not timely filed. — A continuation statement that is not filed within the six-month period prescribed by G.S. 25-9-515(d) is ineffective. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Ineffectiveness of Unauthorized or Overbroad Filings.** Subsection (a) provides that a filed financing statement is effective only to the extent it was filed by a person entitled to file it.

Example 1: Debtor authorizes the filing of a financing statement covering inventory. Under section 9-509, the secured party may file a financing statement covering only inventory; it may not file a financing statement covering other collateral. The secured party files a financing statement covering inventory and equipment. This section provides that the financing statement is effective only to the extent the secured party may file it. Thus, the financing statement is effective to perfect a security interest in inventory but ineffective to perfect a security interest in equipment.

3. **Multiple Secured Parties of Record.** Section 9-509(e) permits any secured party of record to authorize the filing of most amendments. Subsection (b) of this section prevents a filing authorized by one secured party of record from affecting the rights and powers of another secured party of record without the latter's consent.

Example 2: Debtor creates a security interest in favor of A and B. The filed financing statement names A and B as the secured parties. An amendment deleting some collateral covered by the financing statement is filed pursuant to B's authorization. Although B's security interest in the deleted collateral becomes unperfected, A's security interest remains perfected in all the collateral.

Example 3: Debtor creates a security interest in favor of A and B. The financing statement names A and B as the secured parties. A termination statement is filed pursuant to B's authorization. Although the effectiveness of the financing statement terminates with respect to B's security interest, A's rights are unaffected. That is, the financing statement continues to be effective to perfect A's security interest.

4. **Continuation Statements.** A continuation statement may be filed only within the six months immediately before lapse. See section 9-515(d). The filing office is obligated to reject a continuation statement that is filed outside the six-month period. See sections 9-516(b)(7) and 9-520(a). Subsection (c) provides that if the filing office fails to reject a continuation statement that is not filed in a timely manner, the continuation statement is ineffective nevertheless.

§ 25-9-511. Secured party of record.

(a) Secured party of record. — A secured party of record with respect to a financing statement is a person whose name is provided as the name of the secured party or a representative of the secured party in an initial financing statement that has been filed. If an initial financing statement is filed under G.S. 25-9-514(a), the assignee named in the initial financing statement is the secured party of record with respect to the financing statement.

(b) Amendment naming secured party of record. — If an amendment of a financing statement which provides the name of a person as a secured party or a representative of a secured party is filed, the person named in the amendment is a secured party of record. If an amendment is filed under G.S. 25-9-514(b), the assignee named in the amendment is a secured party of record.

(c) Amendment deleting secured party of record. — A person remains a secured party of record until the filing of an amendment of the financing statement which deletes the person. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Secured Party of Record.** This new section explains how the secured party of record is to be determined. If SP-1 is named as the secured party in an initial financing statement, it is the secured party of record. Similarly, if an initial financing statement reflects a total assignment from SP-0 to SP-1, then SP-1 is the secured party of record. See subsection (a). If, subsequently, an amendment is filed assigning SP-1's status to SP-2, then SP-2 becomes the secured party of record in place of SP-1. The same result obtains if a subsequent amendment deletes the reference to SP-1 and substitutes therefor a reference to SP-2. If, however, a subsequent amendment adds SP-2 as a secured party but does not purport to remove SP-1 as a secured party, then SP-2 and SP-1 each is a secured party of record. See subsection (b). An amendment purporting to remove the only secured party of record without providing a successor is ineffective. See section 9-512(e). At any point in time, all effective records that comprise a financing statement must be examined to determine the person or persons that have the status of secured party of record.

3. **Successor to Secured Party of Record.** Application of other law may result in a person succeeding to the powers of a secured party of record. For example, if the secured party of record (A) merges into another corporation (B) and the other corporation (B) survives, other law may provide that B has all of A's powers. In that case, B is authorized to take all actions under this part that A would have been authorized to take. Similarly, acts taken by a person who is authorized under generally applicable principles of agency to act on behalf of the secured party of record are effective under this part.

§ 25-9-512. Amendment of financing statement.

(a) Amendment of information in financing statement. — Subject to G.S. 25-9-509, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or, subject to subsection (e) of this section, otherwise amend the information provided in, a financing statement by filing an amendment that:

(1) Identifies, by its file number, the initial financing statement to which the amendment relates; and

(2) If the amendment relates to an initial financing statement filed in a filing office described in G.S. 25-9-501(a)(1), provides the name of the debtor and the information specified in G.S. 25-9-502(b).

(b) Period of effectiveness not affected. — Except as otherwise provided in G.S. 25-9-515, the filing of an amendment does not extend the period of effectiveness of the financing statement.

(c) Effectiveness of amendment adding collateral. — A financing statement that is amended by an amendment that adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

(d) Effectiveness of amendment adding debtor. — A financing statement that is amended by an amendment that adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

(e) Certain amendments ineffective. — An amendment is ineffective to the extent it:

(1) Purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement; or

(2) Purports to delete all secured parties of record and fails to provide the name of a new secured party of record. (1899, cc. 17, 247; 1901, cc. 329,

704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-402(4).

2. **Changes to Financing Statements.** This section addresses changes to financing statements, including addition and deletion of collateral. Although termination statements, assignments, and continuation statements are types of amendments, this article follows former article 9 and contains separate sections containing additional provisions applicable to particular types of amendments. See section 9-513 (termination statements); 9-514 (assignments); and 9-515 (continuation statements). One should not infer from this separate treatment that this article requires a separate amendment to accomplish each change. Rather, a single amendment would be legally sufficient to, e.g., add collateral and continue the effectiveness of the financing statement.

3. **Amendments.** An amendment under this article may identify only the information contained in a financing statement that is to be changed; alternatively, it may take the form of an amended and restated financing statement. The latter would state, for example, that the financing statement "is amended and restated to read as follows: . . ." References in this part to an "amended financing statement" are to a financing statement as amended by an amendment using either technique.

This section revises former section 9-402(4) to permit secured parties of record to make changes in the public record without the need to obtain the debtor's signature. However, the filing of an amendment that adds collateral or adds a debtor must be authorized by the debtor or it will not be effective. See sections 9-509(a) and 9-510(a).

4. **Amendment Adding Debtor.** An amendment that adds a debtor is effective, provided that the added debtor authorizes the filing. See section 9-509(a). However, filing an amendment adding a debtor to a previously filed financing statement affords no advantage over filing an initial financing statement against that debtor and may be disadvantageous. With respect to the added debtor, for purposes of determining the priority of the security interest, the time of filing is the time of the filing of the amendment, not the time of the filing of the initial financing statement. See subsection (d). However, the effectiveness of the financing statement lapses with respect to added debtor at the time it lapses with respect to the original debtor. See subsection (b).

5. **Deletion of All Debtors or Secured Parties of Record.** Subsection (e) assures that there will be a debtor and secured party of record for every financing statement.

Example: A filed financing statement names A and B as secured parties of record and covers inventory and equipment. An amendment deletes equipment and purports to delete A and B as secured parties of record without adding a substitute secured party. The amendment is ineffective to the extent it purports to delete the secured parties of record but effective with respect to the deletion of collateral. As a consequence, the financing statement, as amended, covers only inventory, but A and B remain as secured parties of record.

NORTH CAROLINA COMMENT

Subsection (a) is Alternative A of the uniform text. Subdivision (a)(2) is modified by inserting the phrase "the name of the debtor and."

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Notice to Debtor Not Required. — This section does not require notice to the debtors by the creditor of any action taken pursuant to the section. Southern Disct. Co. v. Ivey, 13 Bankr. 27 (Bankr. W.D.N.C. 1981).

§ 25-9-513. Termination statement.

(a) Consumer goods. — A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(1) There is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) The debtor did not authorize the filing of the initial financing statement.

(b) Time for compliance with subsection (a). — To comply with subsection (a) of this section, a secured party shall cause the secured party of record to file the termination statement:

(1) Within one month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) If earlier, within 20 days after the secured party receives an authenticated demand from a debtor.

(c) Other collateral. — In cases not governed by subsection (a) of this section, within 20 days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(1) Except in the case of a financing statement covering accounts or chattel paper that has been sold or goods that are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value;

(2) The financing statement covers accounts or chattel paper that has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(3) The financing statement covers goods that were the subject of a consignment to the debtor but are not in the debtor's possession; or

(4) The debtor did not authorize the filing of the initial financing statement.

(d) Effect of filing termination statement. — Except as otherwise provided in G.S. 25-9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in G.S. 25-9-510, for purposes of G.S. 25-9-519(g), 25-9-522(a), and 25-9-523(c), the filing with the filing office of a termination statement relating to a financing statement that indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse. (1945, c. 182, s. 5; c. 196, s. 3; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1973, c. 1316, ss. 2, 3; 1975, c. 862, s. 7; 1985, c. 221; 1989, c. 523, s. 5; 1991, c. 164, s. 2; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-404.

2. **Duty to File or Send.** This section specifies when a secured party must cause the secured party of record to file or send to the debtor a termination statement for a financing statement. Because most financing statements expire in five years unless a continuation statement is filed (section 9-515), no compulsion is placed on the secured party to file a termination statement unless demanded by the debtor, except in the case of consumer goods. Because many consumers will not realize the importance to them of clearing the public record, an affirmative duty is put on the secured party in

that case. But many purchase-money security interests in consumer goods will not be filed, except for motor vehicles. See section 9-309(1). Under section 9-311(b), compliance with a certificate of title statute is "equivalent to the filing of a financing statement under this article." Thus, this section applies to a certificate of title unless the section is superseded by a certificate of title statute that contains a specific rule addressing a secured party's duty to cause a notation of a security interest to be removed from a certificate of title. In the context of a certificate of title, however, the secured party could comply with this section by causing the removal itself or providing the debtor with documentation sufficient to enable the debtor to effect the removal.

Subsections (a) and (b) apply to a financing statement covering consumer goods. Subsection (c) applies to other financing statements. Subsections (a) and (c) each makes explicit what was implicit under former article 9: If the debtor did not authorize the filing of a financing statement in the first place, the secured party of record should file or send a termination statement. The liability imposed upon a secured party that fails to comply with subsection (a) or (c) is identical to that imposed for the filing of an unauthorized financing statement or amendment. See section 9-625(e).

3. **"Bogus" Filings.** A secured party's duty to send a termination statement arises when the secured party "receives" an authenticated demand from the debtor. In the case of an unauthorized financing statement, the person named as debtor in the financing statement may have no relationship with the named secured party and no reason to know the secured party's address. Inasmuch as the address in the financing statement is "held out by (the person named as secured party in the financing statement) as the place for receipt of such communications (i.e., communications relating to security interests)," the putative secured party is deemed to have "received" a notification delivered to that address. See section 1-201(26). If a termination statement is not forthcoming, the person named as debtor itself may authorize the filing of a termination statement, which will be effective if it indicates that the person authorized it to be filed. See sections 9-509(d)(2) and 9-510(c).

4. **Buyers of Receivables.** Applied literally, former section 9-404(1) would have required many buyers of receivables to file a termination statement immediately upon filing a financing statement because "there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value." Subsections (a)(1) and (2) remedy this problem. While the security interest of a buyer of accounts or chattel paper (B-1) is perfected, the debtor is not deemed to retain an interest in the sold receivables and thus could transfer no interest in them to another buyer (B-2) or to a lien creditor (LC). However, for purposes of determining the rights of the debtor's creditors and certain purchasers of accounts or chattel paper from the debtor, while B-1's security interest is unperfected, the debtor-seller is deemed to have rights in the sold receivables, and a competing security interest or judicial lien may attach to those rights. See sections 9-109 and 9-318 and comment 5. Suppose that B-1's security interest in certain accounts and chattel paper is perfected by filing, but the effectiveness of the financing statement lapses. Both before and after lapse, B-1 collects some of the receivables. After lapse, LC acquires a lien on the accounts and chattel paper. B-1's unperfected security interest in the accounts and chattel paper is subordinate to LC's rights. See section 9-317(a)(2). But collections on accounts and chattel paper are not "accounts" or "chattel paper." Even if B-1's security interest in the accounts and chattel paper is or becomes unperfected, neither the debtor nor LC acquires rights to the collections that B-1 collects (and owns) before LC acquires a lien.

5. **Effect of Filing.** Subsection (b) states the effect of filing a termination statement: The related financing statement ceases to be effective. If one of several secured parties of record files a termination statement, subsection (b) applies only with respect to the rights of the person who authorized the filing of the termination statement. See section 9-510(b). The financing statement remains effective with respect to the rights of the others. However, even if a financing statement is terminated (and thus no longer is effective) with respect to all secured parties of record, the financing statement, including the termination statement, will remain of record until at least one year after it lapses with respect to all secured parties of record. See section 9-519(g).

CASE NOTES

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

§ 25-9-514. Assignment of powers of secured party of record.

(a) Assignment reflected on initial financing statement. — Except as otherwise provided in subsection (c) of this section, an initial financing statement may reflect an assignment of all of the secured party's power to authorize an amendment to the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party.

(b) Assignment of filed financing statement. — Except as otherwise provided in subsection (c) of this section, a secured party of record may assign of record all or part of its power to authorize an amendment to a financing statement by filing in the filing office an amendment of the financing statement which:

(1) Identifies, by its file number, the initial financing statement to which it relates;
(2) Provides the name of the assignor; and
(3) Provides the name and mailing address of the assignee.

(c) Assignment of record of mortgage. — An assignment of record of a security interest in a fixture covered by a record of a mortgage which is effective as a financing statement filed as a fixture filing under G.S. 25-9-502(c) may be made only by an assignment of record of the mortgage in the manner provided by law of this State other than this Chapter. (1965, c. 700, s. 1; 1967, c. 24, s. 23; 1969, c. 1115, s. 1; 1973, c. 1316, ss. 4, 5; 1975, c. 862, s. 7; 1983, c. 713, ss. 24, 25; 1987, c. 792, ss. 7, 8; 1989, c. 523, s. 6; 1997-456, s. 55.3; 1997-475, s. 5.5; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-405.

2. **Assignments.** This section provides a permissive device whereby a secured party of record may effectuate an assignment of its power to affect a financing statement. It may also be useful for a secured party who has assigned all or part of its security interest or agricultural lien and wishes to have the fact noted of record, so that inquiries concerning the transaction would be addressed to the assignee. See section 9-502, comment 2. Upon the filing of an assignment, the assignee becomes the "secured party of record" and may authorize the filing of a continuation statement, termination statement, or other amendment. Note that under section 9-310(c) no filing of an assignment is required as a condition of continuing the perfected status of the security interest against creditors and transferees of the original debtor. However, if an assignment is not filed, the assignor remains the secured party of record, with the power (even if not the right) to authorize the filing of effective amendments. See sections 9-509(d) and 9-511(c).

Where a record of a mortgage is effective as a financing statement filed as a fixture filing (section 9-502(c)), then an assignment of record of the security interest may be made only in the manner in which an assignment of record of the mortgage may be made under local real property law.

3. **Comparison to Prior Law.** Most of the changes reflected in this section are for clarification or to embrace medium-neutral drafting. As a general matter, this section preserves the opportunity given by former section 9-405 to assign a security interest of record in one of two different ways. Under subsection (a), a secured party may assign all of its power to affect a financing statement by naming an assignee in the initial financing statement. The secured party of record may accomplish the same result under subsection (b) by making a subsequent filing. Subsection (b) also may be used for an assignment of only some of the secured party of record's power to affect a financing statement, e.g., the power to affect the financing statement as it relates to particular items of collateral or as it relates to an undivided interest in a security interest in all the collateral. An initial financing statement may not be used to change the secured party of record under these circumstances. However, an amendment adding the assignee as a secured party of record may be used.

§ 25-9-515. Duration and effectiveness of financing statement; effect of lapsed financing statement.

(a) Five-year effectiveness. — Except as otherwise provided in subsections (b), (e), (f), and (g) of this section, a filed financing statement is effective for a period of five years after the date of filing.

(b) Public-finance or manufactured-home transaction. — Except as otherwise provided in subsections (e), (f), and (g) of this section, an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction is effective for a period of 30 years after the date of filing if it indicates that it is filed in connection with a public-finance transaction or manufactured-home transaction.

(c) Lapse and continuation of financing statement. — The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d) of this section. Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

(d) When continuation statement may be filed. — A continuation statement may be filed only within six months before the expiration of the five-year period specified in subsection (a) of this section or the 30-year period specified in subsection (b) of this section, whichever is applicable.

(e) Effect of filing continuation statement. — Except as otherwise provided in G.S. 25-9-510, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the financing statement lapses in the same manner as provided in subsection (c) of this section, unless, before the lapse, another continuation statement is filed pursuant to subsection (d) of this section. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(f) Transmitting utility financing statement. — If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

(g) Record of mortgage as financing statement. — A record of a mortgage that is effective as a financing statement filed as a fixture filing under G.S. 25-9-502(c) remains effective as a financing statement filed as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-403(2), (3), and (6).

2. **Period of Financing Statement's Effectiveness.** Subsection (a) states the general rule: A financing statement is effective for a five-year period unless its effectiveness is continued under this section or terminated under section 9-513. Subsection (b) provides that if the financing statement relates to a public-finance transaction or a manufactured-home

transaction and so indicates, the financing statement is effective for 30 years. These financings typically extend well beyond the standard, five-year period. Under subsection (f), a financing statement filed against a transmitting utility remains effective indefinitely, until a termination statement is filed. Likewise, under subsection (g), a mortgage effective as a fixture filing remains effective until its effectiveness terminates under real property law.

3. **Lapse.** When the period of effectiveness under subsection (a) or (b) expires, the effectiveness of the financing statement lapses. The last sentence of subsection (c) addresses the effect of lapse. The deemed retroactive unperfection applies only with respect to purchasers for value; unlike former section 9-403(2), it does not apply with respect to lien creditors.

Example 1: SP-1 and SP-2 both hold security interests in the same collateral. Both security interests are perfected by filing. SP-1 filed first and has priority under section 9-322(a)(1). The effectiveness of SP-1's filing lapses. As long as SP-2's security interest remains perfected thereafter, SP-2 is entitled to priority over SP-1's security interest, which is deemed never to have been perfected as against a purchaser for value (SP-2). See section 9-322(a)(2).

Example 2: SP holds a security interest perfected by filing. On July 1, LC acquires a judicial lien on the collateral. Two weeks later, the effectiveness of the financing statement lapses. Although the security interest becomes unperfected upon lapse, it was perfected when LC acquired its lien. Accordingly, notwithstanding the lapse, the perfected security interest has priority over the rights of LC, who is not a purchaser. See section 9-317(a)(2).

4. **Effect of Debtor's Bankruptcy.** Under former section 9-403(2), lapse was tolled if the debtor entered bankruptcy or another insolvency proceeding. Nevertheless, being unaware that insolvency proceedings had been commenced, filing offices routinely removed records from the files as if lapse had not been tolled. Subsection (c) deletes the former tolling provision and thereby imposes a new burden on the secured party: To be sure that a financing statement does not lapse during the debtor's bankruptcy. The secured party can prevent lapse by filing a continuation statement, even without first obtaining relief from the automatic stay. See Bankruptcy Code section 362(b)(3). Of course, if the debtor enters bankruptcy before lapse, the provisions of this article with respect to lapse would be of no effect to the extent that federal bankruptcy law dictates a contrary result (e.g., to the extent that the Bankruptcy Code determines rights as of the date of the filing of the bankruptcy petition).

5. **Continuation Statements.** Subsection (d) explains when a continuation statement may be filed. A continuation statement filed at a time other than that prescribed by subsection (d) is ineffective, see section 9-510(c), and the filing office may not accept it. See sections 9-516(b) and 9-520(a). Subsection (e) specifies the effect of a continuation statement and provides for successive continuation statements.

NORTH CAROLINA COMMENT

Under North Carolina law, manufactured homes may be deemed to be motor vehicles (see G.S. 20-50) and subject to the laws governing motor vehicles with respect to the perfection of security interests in them or to be an improvement to real property or real property (see G.S. 47-20.6 and G.S. 47-20.7) and subject to the laws governing real property with respect to the perfection of security interests in them.

Legal Periodicals. — For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

For 1997 legislative survey, see 20 Campbell L. Rev. 481.

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Tolling of Four-Month Window for Filing Financing Papers. — Four-month window within which a creditor had to file financing papers after a debtor moved to a new jurisdiction was tolled when the bankruptcy filing occurred; good-faith transferees did not take the equipment at issue free from the creditors' liens, and the bankruptcy trustee took the equipment subject to the liens when he avoided the transactions to the good-faith transferees and recovered the equipment (decided under former G.S. 25-9-403). Whitaker v. CIT Group/

Equip. Fin., Inc. (In re Crowell), 304 B.R. 255, 2004 U.S. Dist. LEXIS 1326 (W.D.N.C. 2004).

A lien by levy pursuant to judgment does not relate back to the filing date of the financing statement when the security interest has become unperfected by the lapse of time. Hassell v. First Pa. Bank, 41 N.C. App. 296, 254 S.E.2d 768 (1979).

Priority Based on First to File. — Where a bank loaned money to a debtor and filed a financing statement in 1999 and a partnership entered into a factoring agreement with the debtor but did not file a statement until 2003, the bank had a priority lien on the proceeds at issue because it perfected its security interest several years before the partnership; also, a purported financing statement amendment failed to include a security agreement showing an assignment of the security interest in certain accounts receivable. Rentenbach Constructors, Inc. v. CM P'ship, — N.C. App. —, 639 S.E.2d 16, 2007 N.C. App. LEXIS 79 (2007).

Security Interest in Mobile Home Affixed to Real Property. — A perfected lien noted on the certificate of title remains superior despite the annexation of the mobile home to realty. Hughes v. Young, 115 N.C. App. 325, 444 S.E.2d 248 (1994).

Once the title certificate has been issued for a mobile home and a creditor has perfected a lien upon the mobile home by registering its lien on the title certificate, the mobile home does not lose its status as a mobile home merely because the owner thereafter permanently affixes it to the land; therefore, the secured creditor with a lien on the title prevails over a subsequent creditor who takes a deed of trust on the land and mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

Where a duly licensed mobile home dealer purchased a doublewide from the manufacturer and attached it to a fixed, permanent foundation before transferring the lot and doublewide to the transferee, and the parties did not intend for the doublewide to be operated upon the highways, there was no requirement that the doublewide be registered or that a certificate of title be obtained by either party; therefore, the deed of trust created an encumbrance on both the land and the mobile home. In re Meade, 174 Bankr. 49 (Bankr. M.D.N.C. 1994).

No fixture filing was required, despite the fact that the mobile home was attached to realty, because G.S. 20-58 *et seq.* provides the exclusive method for a first mortgagee to perfect a security interest in a mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

A mobile home is a motor vehicle, and is subject to the mandatory provisions of the statutes relating to the registration of motor vehicles in this State. King Homes, Inc. v. Bryson, 273 N.C. 84, 159 S.E.2d 329 (1968).

Vehicle "Required to be Registered." — A vehicle is "required to be registered" only if the owner intends to operate it on state highways and only if the vehicle is not exempt from statutory registration requirements; both of these disjunctive requirements must be met before the vehicle is "required to be registered." Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

When Mobile Home is Not Vehicle. — Mobile home was not a motor vehicle "required to be registered," where it was permanently affixed to real estate and the owner had no intention to operate it on highways; thus, the creditor properly perfected his interest by recording a deed of trust for the real estate to which the mobile home was affixed. Butler v. Green Tree Fin. Servicing Corp. (In re Wester), 229 Bankr. 348 (Bankr. E.D.N.C. 1998).

OPINIONS OF ATTORNEY GENERAL

A continuation statement must be filed within the six-month period prior to the last date the original financing statement would have been effective. See opinion of Attorney General to Eunice Avers, Register of Deeds, Forsyth County, 46 N.C.A.G. 209 (1977), rendered prior to 2000 revision of Article 9.

Continuation from Last Effective Date of Original Statement. — The financing statement is continued for five years from the last date the original statement would have been effective if no continuation had been filed. See opinion of Attorney General to Eunice Avers, Register of Deeds, Forsyth County, 46 N.C.A.G. 209 (1977), rendered prior to 2000 revision of Article 9.

§ 25-9-516. What constitutes filing; effectiveness of filing.

(a) What constitutes filing. — Except as otherwise provided in subsection (b) of this section, communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing.

(b) Refusal to accept record; filing does not occur. — Filing does not occur with respect to a record that a filing office refuses to accept because:

(1) The record is not communicated by a method or medium of communication authorized by the filing office;

(2) An amount equal to or greater than the applicable filing fee is not tendered;

(3) The filing office is unable to index the record because:

a. In the case of an initial financing statement, the record does not provide a name for the debtor;

b. In the case of an amendment or correction statement, the record:

1. Does not identify the initial financing statement as required by G.S. 25-9-512 or G.S. 25-9-518, as applicable; or

2. Identifies an initial financing statement whose effectiveness has lapsed under G.S. 25-9-515;

c. In the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's last name; or

d. In the case of a record filed in the filing office described in G.S. 25-9-501(a)(1), the record does not provide a sufficient description of the real property to which it relates;

(4) In the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;

(5) In the case of an initial financing statement or an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not:

a. Provide a mailing address for the debtor;

b. Indicate whether the debtor is an individual or an organization; or

c. If the financing statement indicates that the debtor is an organization, provide:

1. A type of organization for the debtor;

2. A jurisdiction of organization for the debtor; or

3. An organizational identification number for the debtor or indicate that the debtor has none;

(6) In the case of an assignment reflected in an initial financing statement under G.S. 25-9-514(a) or an amendment filed under G.S. 25-9-514(b), the record does not provide a name and mailing address for the assignee;

(7) In the case of a continuation statement, the record is not filed within the six-month period prescribed by G.S. 25-9-515(d); or

(8) In the case of a record presented for filing at the Department of the Secretary of State, the Secretary of State determines that the record is not created pursuant to this Chapter or is otherwise intended for an improper purpose, such as to hinder, harass, or otherwise wrongfully interfere with any person.

(c) Rules applicable to subsection (b). — For purposes of subsection (b) of this section:

(1) A record does not provide information if the filing office is unable to read or decipher the information; and

(2) A record that does not indicate that it is an amendment or identify an initial financing statement to which it relates, as required by G.S. 25-9-512, 25-9-514, or 25-9-518, is an initial financing statement.

(d) Refusal to accept record; record effective as filed record. — A record that is communicated to the filing office with tender of the filing fee, but which the filing office refuses to accept for a reason other than one set forth in subsection (b) of this section, is effective as a filed record except as against a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record from the files. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4; 2000-169, s. 1; 2001-231, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

1. **Source.** Subsection (a): Former section 9-403(1); the remainder is new.

2. **What Constitutes Filing.** Subsection (a) deals generically with what constitutes filing of a record, including an initial financing statement and amendments of all kinds (e.g., assignments, termination statements, and continuation statements). It follows former section 9-403(1), under which either acceptance of a record by the filing office or presentation of the record and tender of the filing fee constitutes filing.

3. **Effectiveness of Rejected Record.** Subsection (b) provides an exclusive list of grounds upon which the filing office may reject a record. See section 9-520(a). Although some of these grounds would also be grounds for rendering a filed record ineffective (e.g., an initial financing statement does not provide a name for the debtor), many others would not be (e.g., an initial financing statement does not provide a mailing address for the debtor or secured party of record). Neither this section nor section 9-520 requires or authorizes the filing office to determine, or even consider, the accuracy of information provided in a record. For example, the State A filing office may not reject under subsection (b)(5)(C) an initial financing statement indicating that the debtor is a State A corporation and providing a three-digit organizational identification number, even if all State A organizational identification numbers contain at least five digits and two letters. Some organization that are not registered organizations (such as foreign corporations) have a read-ily determinable jurisdiction of organization. When that is not the case, with respect to an organization that is not a registered organization, for purposes of this section, the debtor's jurisdiction of organization is any ju-risdiction that bears a reasonable relation to the debtor, such as the jurisdiction stated in any organizational document or agreement for the debtor as the jurisdiction under whose law the organization is formed or as the jurisdiction whose law is the governing law, or the jurisdiction in which the debtor is located under Section 9-307(b) (i.e., its place of business or its chief executive office). Thus, for purposes of this section, more than one jurisdic-tion may qualify as the debtor's jurisdiction of organization. See Comment 9.

A financing statement or other record that is communicated to the filing office but which the filing office refuses to accept provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (d) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (d) contains a special rule to protect a third-party purchaser of the collateral (e.g., a buyer or competing secured party) who gives value in reliance upon the apparent absence of the record from the files. As against a person who searches the public record and reasonably relies on what the public record shows, subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system because of the filing office's wrongful rejection of it. (Compare section 9-517, under which a mis-indexed financing statement is fully effective.) This risk is likely to be small, particularly when a record is presented electronically, and the filer can guard against this risk by conducting a post-filing search of the records. Moreover, section 9-520(b) requires the filing office to give prompt notice of its refusal to accept a record for filing.

4. **Method or Medium of Communication.** Rejection pursuant to subsection (b)(1) for failure to communicate a record properly

should be understood to mean noncompliance with procedures relating to security, authentication, or other communication-related requirements that the filing office may impose. Subsection (b)(1) does not authorize a filing office to impose additional substantive requirements. See section 9-520, comment 2.

5. **Address for Secured Party of Record.** Under subsection (b)(4) and section 9-520(a), the lack of a mailing address for the secured party of record requires the filing office to reject an initial financing statement. The failure to include an address for the secured party of record no longer renders a financing statement ineffective. See section 9-502(a). The function of the address is not to identify the secured party of record but rather to provide an address to which others can send required notifications, e.g., of a purchase-money security interest in inventory or of the disposition of collateral. Inasmuch as the address shown on a filed financing statement is an "address that is reasonable under the circumstances," a person required to send a notification to the secured party may satisfy the requirement by sending a notification to that address, even if the address is or becomes incorrect. See section 9-102 (definition of "send"). Similarly, because the address is "held out by (the secured party) as the place for receipt of such communications (i.e., communications relating to security interests)," the secured party is deemed to have received a notification delivered to that address. See section 1-201(26).

6. **Uncertainty Concerning Individual Debtor's Last Name.** Subsection (b)(3)(C) requires the filing office to reject an initial financing statement or amendment adding an individual debtor if the office cannot index the record because it does not identify the debtor's last name (e.g., it is unclear whether the debtor's name is Elton John or John Elton).

7. **Inability of Filing Office to Read or Decipher Information.** Under subsection (c)(1), if the filing office cannot read or decipher information, the information is not provided by a record for purposes of subsection (b).

8. **Classification of Records.** For purposes of subsection (b), a record that does not indicate it is an amendment or identify an initial financing statement to which it relates is deemed to be an initial financing statement. See subsection (c)(2).

9. **Effectiveness of Rejectable But Unrejected Record.** Section 9-520(a) requires the filing office to refuse to accept an initial financing statement for a reason set forth in subsection (b). However, if the filing office accepts such a financing statement nevertheless, the financing statement generally is effective if it complies with the requirements of section 9-502(a) and (b). See section 9-520(c). Similarly, an otherwise effective financing statement generally remains so even though the information in the financing statement becomes incorrect. See section 9-507(b). (Note that if the information required by subsection (b)(5) is incorrect when the financing statement is filed, section 9-338 applies.)

NORTH CAROLINA COMMENT

Subdivision (b)(8) has no counterpart in the uniform text.

§ 25-9-517. Effect of indexing errors.

The failure of the filing office to index a record correctly does not affect the effectiveness of the filed record. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Effectiveness of Mis-Indexed Records.** This section provides that the filing office's error in mis-indexing a record does not render ineffective an otherwise effective record. As did former section 9-401, this section imposes the risk of filing-office error on those who search the files rather than on those who file.

§ 25-9-518. Claim concerning inaccurate or wrongfully filed record.

(a) Correction statement. — A person may file in the filing office a correction statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed.

(b) Sufficiency of correction statement. — A correction statement must:

(1) Identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates;
(2) Indicate that it is a correction statement; and
(3) Provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed. A correction statement that is subject to the provisions of subsection (b1) of this section shall include a written certification, under oath, by the person that the contents of the correction statement are true and accurate to the best of the person's knowledge.

(b1) In the case of a correction statement alleging that a previously filed record was wrongfully filed and that it should have been rejected under G.S. 25-9-516(b)(8), the Secretary of State shall, without undue delay, determine whether the contested record was wrongfully filed and should have been rejected. In order to determine whether the record was wrongfully filed, the Secretary of State may require the person filing the correction statement and the secured party to provide any additional relevant information requested by the Secretary of State, including an original or a copy of any security agreement that is related to the record. If the Secretary of State finds that the record was wrongfully filed and should have been rejected under G.S. 25-9-516(b)(8), the Secretary of State shall cancel the record and it shall be void and of no effect.

(c) Record not affected by correction statement. — The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record. (2000-169, s. 1; 2001-231, ss. 2, 3.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Correction Statements.** Former article 9 did not afford a nonjudicial means for a debtor to correct a financing statement or other record that was inaccurate or wrongfully filed. Subsection (a) affords the debtor the right to file a correction statement. Among other requirements, the correction statement must provide the basis for the debtor's belief that the public record should be corrected. See subsection (b). These provisions, which resemble the analogous remedy in the Fair Credit Reporting Act, 15 U.S.C. section 1681i, afford an aggrieved person the opportunity to state its position on the public record. They do not permit an aggrieved person to change the legal effect of the public record. Thus, although a filed correction statement becomes part of the "financing statement," as defined in section 9-102, the filing does not affect the effectiveness of the initial financing statement or any other filed record. See subsection (c).

This section does not displace other provisions of this article that impose liability for making unauthorized filings or failing to file or send a termination statement (see section 9-625(e)), nor does it displace any available judicial remedies.

3. **Resort to Other Law.** This article cannot provide a satisfactory or complete solution to problems caused by misuse of the public records. The problem of "bogus" filings is not limited to the UCC filing system but extends to the real property records, as well. A summary judicial procedure for correcting the public record and criminal penalties for those who misuse the filing and recording systems are likely to be more effective and put less strain on the filing system than provisions authorizing or requiring action by filing and recording offices.

NORTH CAROLINA COMMENT

Subsection (b) is Alternative A of the uniform text. Subdivision (b)(3) is modified by adding the last sentence. Subsection (b1) has no counterpart in the uniform text.

Subpart 2. Duties and Operation of Filing Office.

§ 25-9-519. Numbering, maintaining, and indexing records; communicating information provided in records.

(a) Filing office duties. — For each record filed in a filing office, the filing office shall:

(1) Assign a unique number to the filed record;

(2) Create a record that bears the number assigned to the filed record and the date and time of filing;

(3) Maintain the filed record for public inspection; and

(4) Index the filed record in accordance with subsections (c), (d), and (e) of this section.

(b) File number. — Except as otherwise provided in subsection (i) of this section, a file number assigned after January 1, 2003, must include a digit that:

(1) Is mathematically derived from or related to the other digits of the file number; and

(2) Aids the filing office in determining whether a number communicated as the file number includes a single-digit or transpositional error.

(c) Indexing: general. — Except as otherwise provided in subsections (d) and (e) of this section, the filing office shall:

(1) Index an initial financing statement according to the name of the debtor and index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement; and

(2) Index a record that provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name that was not previously provided.

(d) Indexing: real-property-related financing statement. — If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index it:

(1) Under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and

(2) To the extent that the law of this State provides for indexing of records of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.

(e) Indexing: real-property-related assignment. — If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index an assignment filed under G.S. 25-9-514(a) or an amendment filed under G.S. 25-9-514(b):

(1) Under the name of the assignor as grantor; and

(2) To the extent that the law of this State provides for indexing a record of the assignment of a mortgage under the name of the assignee, under the name of the assignee.

(f) Retrieval and association capability. — The filing office shall maintain a capability:

(1) To retrieve a record by the name of the debtor and by the file number assigned to the initial financing statement to which the record relates; and

(2) To associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

(g) Removal of debtor's name. — The filing office may not remove a debtor's name from the index until one year after the effectiveness of a financing statement naming the debtor lapses under G.S. 25-9-515 with respect to all secured parties of record.

(h) Timeliness of filing office performance. — The filing office shall perform the acts required by subsections (a) through (e) of this section at the time and in the manner prescribed by filing-office rule, but after January 1, 2003, not later than three business days after the filing office receives the record in question.

(i) Inapplicability to real-property-related filing office. — Subsection (b) of this section does not apply to a filing office described in G.S. 25-9-501(a)(1). (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-403(4) and (7), and section 9-405(2).

2. **Filing Office's Duties.** Subsections (a) through (e) set forth the duties of the filing office with respect to filed records. Subsection (h), which is new, imposes a minimum standard of performance for those duties. Prompt indexing is crucial to the effectiveness of any filing system. An accepted but unindexed record affords no public notice. Subsection (f) requires the filing office to maintain appropriate storage and retrieval facilities, and subsection (g) contains minimum requirements for the retention of records.

3. **File Number.** Subsection (a)(1) requires the filing office to assign a unique number to each filed record. That number is the "file number" only if the record is an initial financing statement. See section 9-102.

4. **Time of Filing.** Subsection (a)(2) and section 9-523 refer to the "date and time" of filing. The statutory text does not contain any instructions to a filing office as to how the time of filing is to be determined. The method of determining or assigning a time of filing is an appropriate matter for filing-office rules to address.

5. **Related Records.** Subsections (c) and (f) are designed to ensure that an initial financing statement and all filed records relating to it are associated with one another, indexed under the name of the debtor, and retrieved together. To comply with subsection (f), a filing office (other than a real property recording office in a state that enacts subsection (f), Alternative B) must be capable of retrieving records in each of two ways: By the name of the debtor and by the file number of the initial financing statement to which the record relates.

6. **Prohibition on Deleting Names from Index.** This article contemplates that the filing office will not delete the name of a debtor from the index until at least one year passes after the effectiveness of the financing statement lapses as to all secured parties of record. See subsection (g). This rule applies even if the filing office accepts an amendment purporting to delete or modify the name of a debtor or terminate the effectiveness of the financing statement. If an amendment provides a modified name for a debtor, the amended name should be added to the index, see subsection (c)(2), but the preamendment name should remain in the index.

Compared to former article 9, the rule in subsection (g) increases the amount of information available to those who search the public records. The rule also contemplates that searchers—not the filing office—will determine the significance and effectiveness of filed records.

NORTH CAROLINA COMMENT

The introductory language to subsection (b) is rewritten. Subsection (f) is Alternative A of the uniform text. Subsection (h) is modified by inserting "after January 1, 2003," and by changing "two business days" to "three business days."

§ 25-9-520. Acceptance, refusal to accept record, and cancellation of record.

(a) Mandatory refusal to accept record. — A filing office shall refuse to accept a record for filing for a reason set forth in G.S. 25-9-516(b) and may refuse to accept a record for filing only for a reason set forth in G.S. 25-9-516(b).

(b) Communication concerning refusal. — If a filing office refuses to accept a record for filing or cancels a record under G.S. 25-9-518(b1), it shall communicate to the person that presented the record the fact of and reason for the refusal or cancellation and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but in no event more than three business days after the filing office receives or cancels the record.

(c) When filed financing statement effective. — A filed financing statement satisfying G.S. 25-9-502(a) and (b) is effective, even if the filing office is required to refuse to accept it for filing under subsection (a) of this section. However, G.S. 25-9-338 applies to a filed financing statement providing information described in G.S. 25-9-516(b)(5) which is incorrect at the time the financing statement is filed.

(d) Separate application to multiple debtors. — If a record communicated to a filing office provides information that relates to more than one debtor, this Part applies as to each debtor separately.

(e) Appeal. —

(1) If the Secretary of State refuses to accept a record for filing pursuant to G.S. 25-9-516(b)(8) or cancels a wrongfully filed record pursuant to G.S. 25-9-518(b1), the secured party may file an appeal within 30 days after the refusal or cancellation in the Superior Court of Wake County. Filing a petition requesting to be allowed to file the document commences the appeal. The petition shall be filed with the court and with the Secretary of State and shall have the record attached to it. Upon the commencement of an appeal, it shall be set for hearing at the earliest possible time and shall take precedence over all matters except older matters of the same character. The appeal to the Superior Court is not governed by Article 3, 3A, or 4 of Chapter 150B of the General Statutes and shall be determined upon such further notice and opportunity to be heard, if any, as the court may deem appropriate under the circumstances. The court shall permit the joinder of any interested party that would be allowed under the Rules of Civil Procedure.

(2) Upon consideration of the petition and other appropriate pleadings, the court may order the Secretary of State to file the record or take other action the court considers appropriate, including the entry of orders affirming, reversing, or otherwise modifying the decision of the Secretary of State. The court may order any other relief, including equitable relief, as may be appropriate.

(3) The court's final decision may be appealed as in other civil proceedings. (2000-169, s. 1; 2001-231, s. 4.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Refusal to Accept Record for Filing.** In some states, filing offices considered themselves obligated by former article 9 to review the form and content of a financing statement and to refuse to accept those that they determine are legally insufficient. Some filing offices imposed requirements for or conditions to filing that do not appear in the statute. Under this section, the filing office is not expected to make legal judgments and is not permitted to impose additional conditions or requirements.

Subsection (a) both prescribes and limits the bases upon which the filing office must and may reject records by reference to the reasons set forth in section 9-516(b). For the most part, the bases for rejection are limited to those that prevent the filing office from dealing with a record that it receives—because some of the requisite information (e.g., the debtor's name) is missing or cannot be deciphered, because the record is not communicated by a method (e.g., it is MIME-rather than UU-encoded) or medium (e.g., it is written rather than electronic) that the filing office accepts, or because the filer fails to tender an amount equal to or greater than the filing fee.

3. **Consequences of Accepting Rejectable Record.** Section 9-516(b) includes among the reasons for rejecting an initial financing statement the failure to give certain information that is not required as a condition of effectiveness. In conjunction with section 9-516(b)(5), this section requires the filing office to refuse to accept a financing statement that is legally sufficient to perfect a security interest under section 9-502 but does not contain a mailing address for the debtor, does not disclose whether the debtor is an individual or an organization (e.g., a partnership or corporation) or, if the debtor is an organization, does not give certain specified information concerning the organization. The information required by section 9-516(b)(5) assists searchers in weeding out "false positives," i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor's name is correct and that the financing statement is filed in the proper jurisdiction.

If the filing office accepts a financing statement that does not give this information at all, the filing is fully effective. Section 9-520(c). The financing statement also generally is effective if the information is given but is incorrect; however, section 9-338 affords protection to buyers and holders of perfected security interests who give value in reasonable reliance upon the incorrect information.

4. **Filing Office's Duties with Respect to Rejected Record.** Subsection (b) requires the filing office to communicate the fact of rejection and the reason therefor within a fixed period of time. Inasmuch as a rightfully rejected record is ineffective and a wrongfully rejected record is not fully effective, prompt communication concerning any rejection is important.

5. **Partial Effectiveness of Record.** Under subsection (d), the provisions of this part apply to each debtor separately. Thus, a filing office may reject an initial financing statement or other record as to one named debtor but accept it as to the other.

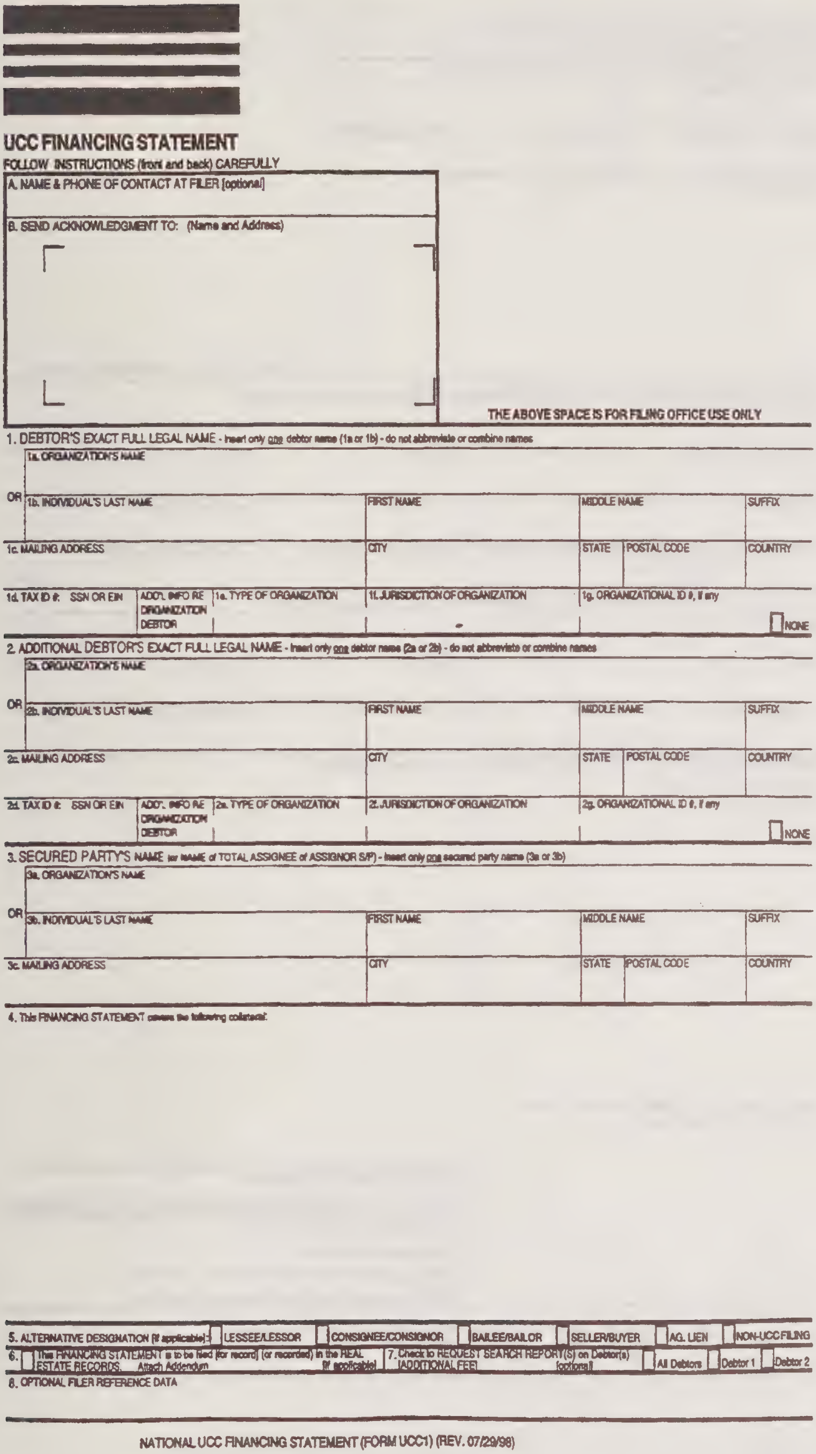
Example: An initial financing statement is communicated to the filing office. The financing statement names two debtors, John Smith and Jane Smith. It contains all of the information described in section 9-516(b)(5) with respect to John but lacks some of the information with respect to Jane. The filing office must accept the financing statement with respect to John, reject it with respect to Jane, and notify the filer of the rejection.

NORTH CAROLINA COMMENT

Subsection (b) is modified by changing "two business days" to "three business days." Subsection (b) is also modified by inserting the phrases "or cancels a record under G.S. 25-9-518(b1)," "or cancellation," and "or cancels." Subsection (e) has no counterpart in the uniform text.

§ 25-9-521. Uniform form of written financing statement and amendment.

(a) Initial financing statement form. — A filing office that accepts written records may not refuse to accept a written initial financing statement in the following form and format except for a reason set forth in G.S. 25-9-516(b):



UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A. NAME & PHONE OF CONTACT AT FILER [optional]

B. SEND ACKNOWLEDGMENT TO: (Name and Address)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (1a or 1b) - do not abbreviate or combine names

1a. ORGANIZATION'S NAME					
OR 1b. INDIVIDUAL'S LAST NAME		FIRST NAME	MIDDLE NAME		SUFFIX
1c. MAILING ADDRESS		CITY	STATE	POSTAL CODE	COUNTRY
1d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	1e. TYPE OF ORGANIZATION	1f. JURISDICTION OF ORGANIZATION	1g. ORGANIZATIONAL ID #, if any	☐ NONE

2. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (2a or 2b) - do not abbreviate or combine names

2a. ORGANIZATION'S NAME					
OR 2b. INDIVIDUAL'S LAST NAME		FIRST NAME	MIDDLE NAME		SUFFIX
2c. MAILING ADDRESS		CITY	STATE	POSTAL CODE	COUNTRY
2d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	2e. TYPE OF ORGANIZATION	2f. JURISDICTION OF ORGANIZATION	2g. ORGANIZATIONAL ID #, if any	☐ NONE

3. SECURED PARTY'S NAME (or NAME of TOTAL ASSIGNEE of ASSIGNOR S/P) - insert only one secured party name (3a or 3b)

3a. ORGANIZATION'S NAME					
OR 3b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME		SUFFIX	
3c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY	

4. This FINANCING STATEMENT covers the following collateral:

5. ALTERNATIVE DESIGNATION [if applicable]: ☐ LESSEE/LESSOR ☐ CONSIGNEE/CONSIGNOR ☐ BAILEE/BAILOR ☐ SELLER/BUYER ☐ AG. LIEN ☐ NON-UCC FILING

6. ☐ This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS. Attach Addendum [if applicable]

7. Check to REQUEST SEARCH REPORT(S) on Debtor(s) [ADDITIONAL FEE] [optional] ☐ All Debtors ☐ Debtor 1 ☐ Debtor 2

8. OPTIONAL FILER REFERENCE DATA

NATIONAL UCC FINANCING STATEMENT (FORM UCC1) (REV. 07/29/98)

UCC FINANCING STATEMENT ADDENDUM

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

9. NAME OF FIRST DEBTOR (1a or 1b) ON RELATED FINANCING STATEMENT

9a. ORGANIZATION'S NAME		
OR 9b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME, SUFFIX

10. MISCELLANEOUS:

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

11. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME - insert only one name (11a or 11b) - do not abbreviate or combine names

11a. ORGANIZATION'S NAME				
OR 11b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME		SUFFIX
11c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

11d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	11e. TYPE OF ORGANIZATION	11f. JURISDICTION OF ORGANIZATION	11g. ORGANIZATIONAL ID #, if any ☐ NONE

12. ☐ ADDITIONAL SECURED PARTY'S or ☐ ASSIGNOR S/P'S NAME - insert only one name (12a or 12b)

12a. ORGANIZATION'S NAME				
OR 12b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME		SUFFIX
12c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY

13. This FINANCING STATEMENT covers ☐ timber to be cut or ☐ as-extracted collateral, or is filed as a ☐ fixture filing.

14. Description of real estate:

15. Name and address of a RECORD OWNER of above-described real estate (if Debtor does not have a record interest):

16. Additional collateral description:

17. Check only if applicable and check only one box.

Debtor is a ☐ Trust or ☐ Trustee acting with respect to property held in trust or ☐ Decedent's Estate

18. Check only if applicable and check only one box.

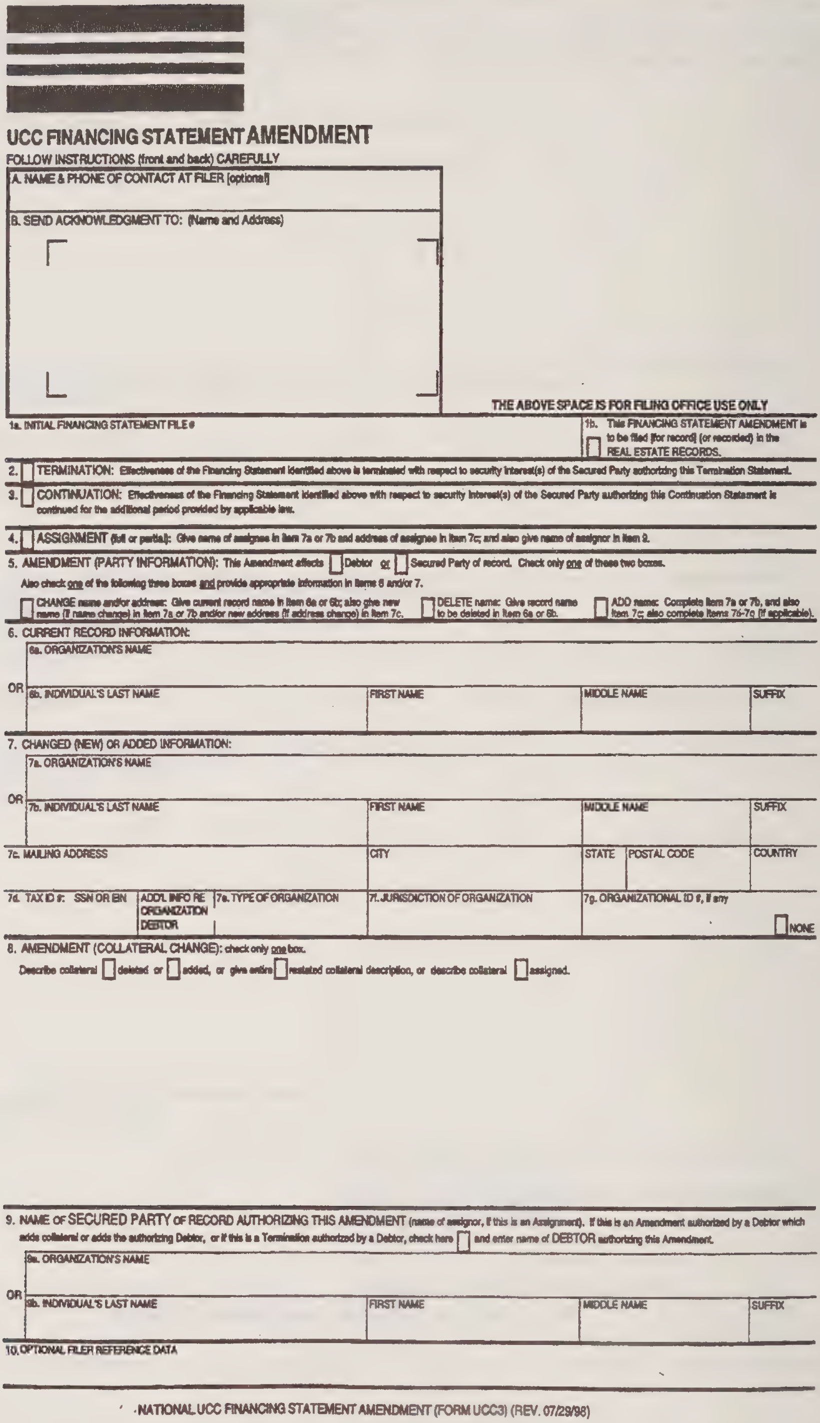
☐ Debtor is a TRANSMITTING UTILITY

☐ Filed in connection with a Manufactured-Home Transaction — effective 30 years

☐ Filed in connection with a Public-Finance Transaction — effective 30 years

NATIONAL UCC FINANCING STATEMENT ADDENDUM (FORM UCC1Ad) (REV. 07/29/98)

(b) Amendment form. — A filing office that accepts written records may not refuse to accept a written record in the following form and format except for a reason set forth in G.S. 25-9-516(b):



UCC FINANCING STATEMENT AMENDMENT

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A. NAME & PHONE OF CONTACT AT FILER [optional]

B. SEND ACKNOWLEDGMENT TO: (Name and Address)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1a. INITIAL FINANCING STATEMENT FILE #	1b. ☐ This FINANCING STATEMENT AMENDMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS.

2. ☐ TERMINATION: Effectiveness of the Financing Statement identified above is terminated with respect to security interest(s) of the Secured Party authorizing this Termination Statement.

3. ☐ CONTINUATION: Effectiveness of the Financing Statement identified above with respect to security interest(s) of the Secured Party authorizing this Continuation Statement is continued for the additional period provided by applicable law.

4. ☐ ASSIGNMENT (full or partial): Give name of assignee in item 7a or 7b and address of assignee in item 7c; and also give name of assignor in item 9.

5. AMENDMENT (PARTY INFORMATION): This Amendment affects ☐ Debtor or ☐ Secured Party of record. Check only one of these two boxes.

Also check one of the following three boxes and provide appropriate information in items 6 and/or 7.

☐ CHANGE name and/or address: Give current record name in item 6a or 6b; also give new name (if name change) in item 7a or 7b and/or new address (if address change) in item 7c.
☐ DELETE name: Give record name to be deleted in item 6a or 6b.
☐ ADD name: Complete item 7a or 7b, and also item 7c; also complete items 7d-7g (if applicable).

6. CURRENT RECORD INFORMATION:

	6a. ORGANIZATION'S NAME			
OR	6b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME	SUFFIX

7. CHANGED (NEW) OR ADDED INFORMATION:

	7a. ORGANIZATION'S NAME					
OR	7b. INDIVIDUAL'S LAST NAME		FIRST NAME	MIDDLE NAME		SUFFIX
7c. MAILING ADDRESS			CITY	STATE	POSTAL CODE	COUNTRY
7d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	7e. TYPE OF ORGANIZATION	7f. JURISDICTION OF ORGANIZATION	7g. ORGANIZATIONAL ID #, if any ☐ NONE		

8. AMENDMENT (COLLATERAL CHANGE): check only one box.

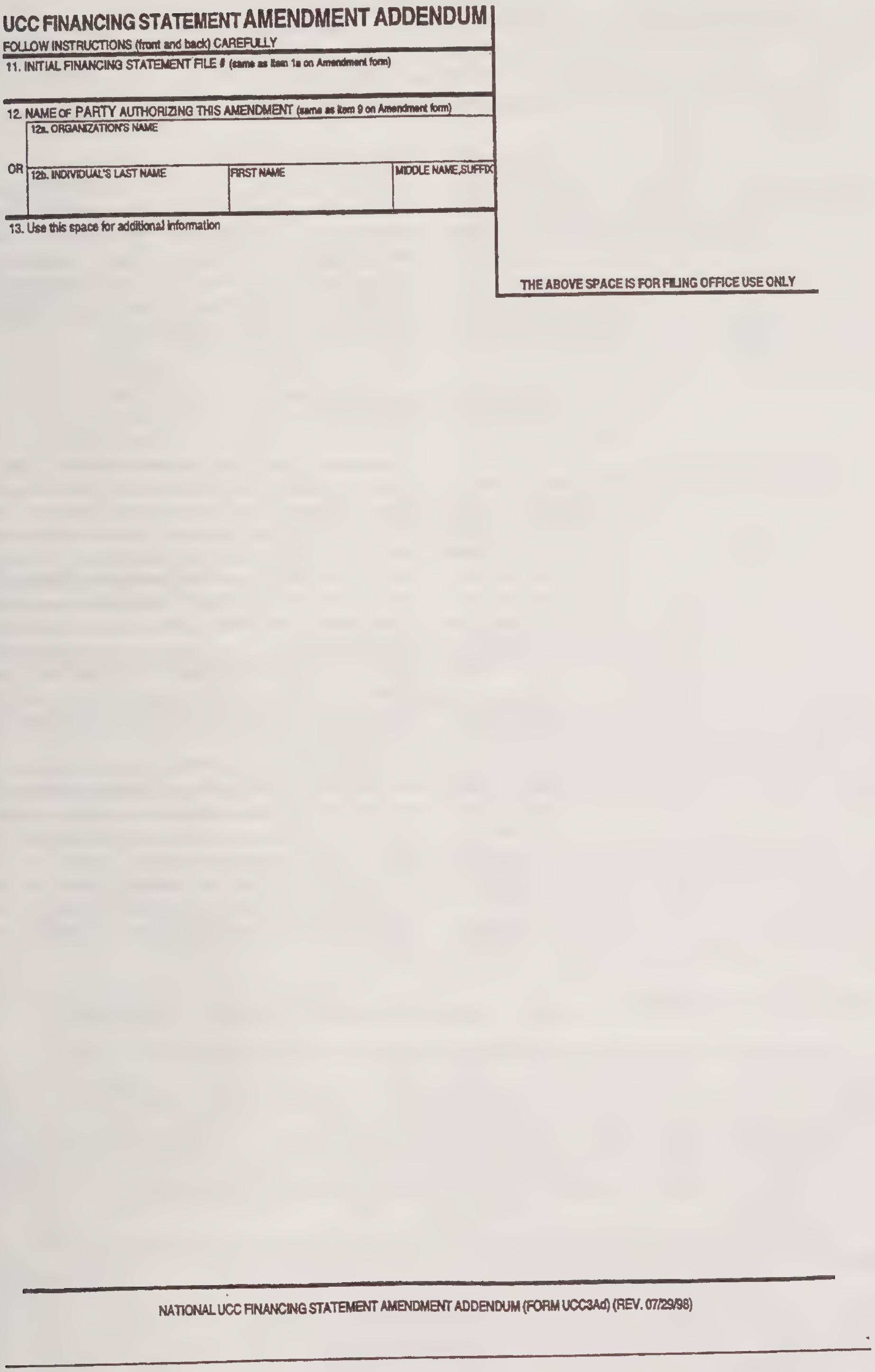
Describe collateral ☐ deleted or ☐ added, or give entire ☐ restated collateral description, or describe collateral ☐ assigned.

9. NAME OF SECURED PARTY OF RECORD AUTHORIZING THIS AMENDMENT (name of assignor, if this is an Assignment). If this is an Amendment authorized by a Debtor which adds collateral or adds the authorizing Debtor, or if this is a Termination authorized by a Debtor, check here ☐ and enter name of DEBTOR authorizing this Amendment.

	9a. ORGANIZATION'S NAME			
OR	9b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME	SUFFIX

10. OPTIONAL FILER REFERENCE DATA

NATIONAL UCC FINANCING STATEMENT AMENDMENT (FORM UCC3) (REV. 07/29/98)



UCC FINANCING STATEMENT AMENDMENT ADDENDUM

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

11. INITIAL FINANCING STATEMENT FILE # (same as item 1a on Amendment form)

12. NAME OF PARTY AUTHORIZING THIS AMENDMENT (same as item 9 on Amendment form)

12a. ORGANIZATION'S NAME

OR

12b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME,SUFFIX

13. Use this space for additional information

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

NATIONAL UCC FINANCING STATEMENT AMENDMENT ADDENDUM (FORM UCC3Ad) (REV. 07/29/98)

(1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7; 2000-169, ss. 1, 2(a)-(c).)

Editor's Note. — Session Laws 2000-169, ss. 2(b) and (2)(c), direct the Revisor of Statutes to cause to be printed in G.S. 25-9-521(a), the National UCC Financing Statement (Form UCC1) (Rev. 07/29/98) and the National UCC Financing Statement Addendum (Form UCC1 Ad) (Rev. 07/29/98), and to cause to be printed in G.S. 25-9-521(b), the National UCC Financing Statement Amendment (Form UCC3) (Rev. 07/29/98) and the National UCC Financing Statement Amendment Addendum (Form UCC3 Ad) (Rev. 07/29/98), both as reproduced in the official text of U.C.C. Article 9 (1999), and incorporates these forms by reference into G.S. 25-9-521(a) and (b), respectively.

OFFICIAL COMMENT

1. **Source.** New.

2. **"Safe Harbor" Written Forms.** Although Section 9-520 limits the bases upon which the filing office can refuse to accept records, this section provides sample written forms that must be accepted in every filing office in the country, as long as the filing office's rules permit it to accept written communications. By completing one of the forms in this section, a secured party can be certain that the filing office is obligated to accept it.

The forms in this section are based upon national financing statement forms that were in use under former Article 9. Those forms were developed over an extended period and reflect the comments and suggestions of filing officers, secured parties and their counsel, and service companies. The formatting of those forms and of the ones in this section has been designed to reduce error by both filers and filing offices.

A filing office that accepts written communications may not reject, on grounds of form or format, a filing using these forms. Although filers are not required to use the forms, they are encouraged and can be expected to do so, inasmuch as the forms are well designed and avoid the risk of rejection on the basis of form or format. As their use expands, the forms will rapidly become familiar to both filers and filing-office personnel. Filing offices may and should encourage the use of these forms by declaring them to be the "standard" (but not exclusive) forms for each jurisdiction, albeit without in any way suggesting that alternative forms are unacceptable.

The multi-purpose form in subsection (b) covers changes with respect to the debtor, the secured party, the collateral, and the status of the financing statement (termination and continuation). A single form may be used for several different types of amendments at once (e.g., both to change a debtor's name and continue the effectiveness of the financing statement.)

§ 25-9-522. Maintenance and destruction of records.

(a) Post-lapse maintenance and retrieval of information. — The filing office shall maintain a record of the information provided in a filed financing statement for at least one year after the effectiveness of the financing statement has lapsed under G.S. 25-9-515 with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and by using the file number assigned to the initial financing statement to which the record relates.

(b) Destruction of written records. — Except to the extent that a statute governing disposition of public records provides otherwise, the filing office immediately may destroy any written record evidencing a financing statement. However, if the filing office destroys a written record, it shall maintain another record of the financing statement which complies with subsection (a) of this section. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c.

1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-403(3), revised substantially.

2. **Maintenance of Records.** Section 9-523 requires the filing office to provide information concerning certain lapsed financing statements. Accordingly, subsection (a) requires the filing office to maintain a record of the information in a financing statement for at least one year after lapse. During that time, the filing office may not delete any information with respect to a filed financing statement; it may only add information. This approach relieves the filing office from any duty to determine whether to substitute or delete information upon receipt of an amendment. It also assures searchers that they will receive all information with respect to financing statements filed against a debtor and thereby be able themselves to determine the state of the public record.

The filing office may maintain this information in any medium. Subsection (b) permits the filing office immediately to destroy written records evidencing a financing statement, provided that the filing office maintains another record of the information contained in the financing statement as required by subsection (a).

NORTH CAROLINA COMMENT

Subsection (a) is Alternative A of the uniform text.

§ 25-9-523. Information from filing office.

(a) Acknowledgment of filing written record. — If a person that files a written record requests an acknowledgment of the filing, the filing office shall send to the person an image of the record showing the number assigned to the record pursuant to G.S. 25-9-519(a)(1) and the date and time of the filing of the record. However, if the person furnishes a copy of the record to the filing office, the filing office may instead:

(1) Note upon the copy the number assigned to the record pursuant to G.S. 25-9-519(a)(1) and the date and time of the filing of the record; and

(2) Send the copy to the person.

(b) Acknowledgment of filing other record. — If a person files a record other than a written record, the filing office shall communicate to the person an acknowledgment that provides:

(1) The information in the record;

(2) The number assigned to the record pursuant to G.S. 25-9-519(a)(1); and

(3) The date and time of the filing of the record.

(c) Communication of requested information. — Except as otherwise provided in subsection (g) of this section, the filing office shall communicate or otherwise make available in a record, for which it shall not be liable, the following information to any person that requests it:

(1) Whether there is on file on a date and time specified by the filing office, but not a date earlier than three business days before the filing office receives the request, any financing statement that:

a. Designates a particular debtor;

b. Has not lapsed under G.S. 25-9-515 with respect to all secured parties of record; and

c. If the request so states, has lapsed under G.S. 25-9-515 and a record of which is maintained by the filing office under G.S. 25-9-522(a);

(2) The date and time of filing of each financing statement; and

(3) The information provided in each financing statement.

(d) Medium for communicating information. — In complying with its duty under subsection (c) of this section, the filing office may communicate information in any medium. However, if requested, the filing office shall communicate information by issuing a record that can be admitted into evidence in the courts of this State without extrinsic evidence of its authenticity.

(e) Timeliness of filing office performance. — The filing office shall perform the acts required by subsections (a) through (d) of this section at the time and in the manner prescribed by filing-office rule, but after January 1, 2003, for a filing office described in G.S. 25-9-501(a)(2), not later than three business days after the filing office receives the request.

(f) Reserved.

(g) Inapplicability to real-property-related filing office. — Subsection (c) of this section does not apply to a filing office described in G.S. 25-9-501(a)(1) with respect to financing statements filed on or after the effective date of this act. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1973, c. 1316, s. 7; 1975, c. 862, s. 7; 1983, c. 713, ss. 27, 28; 1987, c. 792, s. 10; 1997-456, s. 55.3; 1997-475, s. 5.7; 2000-169, s. 1(d).)

OFFICIAL COMMENT

1. **Source.** Former section 9-407; subsections (d) and (e) are new.

2. **Filing Office's Duty to Provide Information.** Former section 9-407, dealing with obtaining information from the filing office, was bracketed to suggest to legislatures that its enactment was optional. Experience has shown that the method by which interested persons can obtain information concerning the public records should be uniform. Accordingly, the analogous provisions of this article are not in brackets.

Most of the other changes from former section 9-407 are for clarification, to embrace medium-neutral drafting, or to impose standards of performance on the filing office.

3. **Acknowledgments of Filing.** Subsections (a) and (b) require the filing office to acknowledge the filing of a record. Under subsection (a), the filing office is required to acknowledge the filing of a written record only upon request of the filer. Subsection (b) requires the filing office to acknowledge the filing of a non-written record even in the absence of a request from the filer.

4. **Response to Search Request.** Subsection (c)(3) requires the filing office to provide "the information contained in each financing statement" to a person who requests it. This requirement can be satisfied by providing copies, images, or reports. The requirement does not in any manner inhibit the filing office from also offering to provide less than all of the information (presumably for a lower fee) to a person who asks for less. Thus, subsection (c) accommodates the practice of providing only the type of record (e.g., initial financing statement, continuation statement), number assigned to the record, date and time of filing, and names and addresses of the debtor and secured party when a requesting person asks for no more (i.e., when the person does not ask for copies of financing statements). In contrast, the filing office's obligation under subsection (b) to provide an acknowledgment containing "the information contained in the record" is not defined by a customer's request. Thus unless the filer stipulates otherwise, to comply with subsection (b) the filing office's acknowledgment must contain all of the information in a record.

Subsection (c) assures that a minimum amount of information about filed records will be available to the public. It does not preclude a filing office from offering additional services.

5. **Lapsed and Terminated Financing Statements.** This section reflects the policy that terminated financing statements will remain part of the filing office's data base. The filing office may remove from the data base only lapsed financing statements, and then only when at least a year has passed after lapse. See section 9-519(g). Subsection (c)(1)(C) requires a filing office to conduct a search and report as to lapsed financing statements that have not been removed from the data base, when requested.

6. **Search by Debtor's Address.** Subsection (c)(1)(A) contemplates that, by making a single request, a searcher will receive the results of a search of the entire public record maintained by any given filing office. Addition of the bracketed language in subsection (c)(1)(A) would permit a search report limited to financing statements showing a particular address for the debtor, but only if the search request is so limited. With or without the bracketed lan-

guage, this subsection does not permit the filing office to compel a searcher to limit a request by address.

7. **Medium of Communication; Certificates.** Former article 9 provided that the filing office respond to a request for information by providing a certificate. The principle of medium-neutrality would suggest that the statute not require a written certificate. Subsection (d) follows this principle by permitting the filing office to respond by communicating "in any medium." By permitting communication "in any medium," subsection (d) is not inconsistent with a system in which persons other than filing office staff conduct searches of the filing office's (computer) records.

Some searchers find it necessary to introduce the results of their search into evidence. Because official written certificates might be introduced into evidence more easily than official communications in another medium, subsection (d) affords states the option of requiring the filing office to issue written certificates upon request. The alternative bracketed language in subsection (d) recognizes that some states may prefer to permit the filing office to respond in another medium, as long as the response can be admitted into evidence in the courts of that state without extrinsic evidence of its authenticity.

8. **Performance Standard.** The utility of the filing system depends on the ability of searchers to get current information quickly. Accordingly, subsection (e) requires that the filing office respond to a request for information no later than two business days after it receives the request. The information contained in the response must be current as of a date no earlier than three business days before the filing office receives the request. See subsection (c)(1). The failure of the filing office to comply with performance standards, such as subsection (e), has no effect on the private rights of persons affected by the filing of records.

9. **Sales of Records in Bulk.** Subsection (f), which is new, mandates that the appropriate official or the filing office sell or license the filing records to the public in bulk, on a nonexclusive basis, in every medium available to the filing office. The details of implementation are left to filing-office rules.

NORTH CAROLINA COMMENT

Subsection (c) is modified by inserting the phrases "Except as otherwise provided in subsection (g) of this section" and "for which it shall not be liable." Subsection (e) is modified by inserting the phrase "after January 1, 2003, for a filing office described in G.S. 25-9-501(a)(2)," and by changing "two business days" to "three business days." Subsection (f) of the uniform text is omitted. Subsection (g) has no counterpart in the uniform text.

§ 25-9-524. Delay by filing office.

Delay by the filing office beyond a time limit prescribed by this Part is excused if:

(1) The delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office; and

(2) The filing office exercises reasonable diligence under the circumstances. (2000-169, s. 1.)

OFFICIAL COMMENT

Source. New; derived from section 4-109.

§ 25-9-525. Fees.

(a) Initial financing statement or other record: general rule. — Except as otherwise provided in subsection (e) of this section, the fee for filing and indexing a record under this Part is:

(1) Thirty-eight dollars ($38.00) if the record is communicated in writing and consists of one or two pages;

(2) Forty-five dollars ($45.00) if the record is communicated in writing and consists of more than two pages, plus two dollars ($2.00) for each page over 10 pages; and

(3) Thirty dollars ($30.00) if the record is communicated by another medium authorized by filing-office rule.

(b) Reserved.

(c) Number of names. — The number of names required to be indexed does not affect the amount of the fee in subsection (a) of this section.

(d) Response to information request. — The fee for responding to a request for information from the filing office, including for communicating whether there is on file any financing statement naming a particular debtor, is:

(1) Thirty-eight dollars ($38.00) if the request is communicated in writing; and

(2) Thirty dollars ($30.00) if the request is communicated by another medium authorized by filing-office rule.

Upon request the filing office shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of two dollars ($2.00) per page. This subsection does not require that a fee be charged for remote access searching of the filing office database.

(e) Record of mortgage. — This section does not require a fee with respect to a record of a mortgage which is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut under G.S. 25-9-502(c). However, the recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4; 2000-169, s. 1; 2003-284, ss. 35B.1(a), 35B.1(b).)

OFFICIAL COMMENT

1. **Source.** Various sections of former part 4.

2. **Fees.** This section contains all fee requirements for filing, indexing, and responding to requests for information. Uniformity in the fee structure (but not necessarily in the amount of fees) makes this article easier for secured parties to use and reduces the likelihood that a filed record will be rejected for failure to pay at least the correct amount of the fee. See section 9-516(b)(2).

The costs of processing electronic records are less than those with respect to written records. Accordingly, this section mandates a lower fee as an incentive to file electronically and imposes the additional charge (if any) for multiple debtors only with respect to written records. When written records are used, this article encourages the use of the uniform forms in section 9-521. The fee for filing these forms should be no greater than the fee for other written records.

To make the relevant information included in a filed record more accessible once the record is found, this section mandates a higher fee for longer written records than for shorter ones. Finally, recognizing that financing statements naming more than one debtor are most often filed against a husband and wife, any additional charge for multiple debtors applies to records filed with respect to more than two debtors, rather than with respect to more than one.

NORTH CAROLINA COMMENT

Subsection (a) is rewritten. Subsection (b) of the uniform text is omitted. Subsection (c) is Alternative A of the uniform text. Subsection (d) is modified by inserting the last two sentences.

Editor's Note. — Session Laws 2003-284, s. 1.2, provides: "This act shall be known as the 'Current Operations and Capital Improvements Appropriations Act of 2003'."

Session Laws 2003-284, s. 48.1, provides: "Parts 32 through 47 of this act do not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by those parts before the effective date of its amendment or repeal; nor do they affect the right to any refund or credit of a tax that accrued under the amended or repealed statute before the effective date of its amendment or repeal."

Session Laws 2003-284, s. 49.3, provides: "Except for statutory changes or other provisions that clearly indicate an intention to have effects beyond the 2003-2005 fiscal biennium, the textual provisions of this act apply only to funds appropriated for, and activities occurring during, the 2003-2005 fiscal biennum."

Session Laws 2003-284, s. 49.5 is a severability clause.

§ 25-9-526. Filing-office rules.

(a) Adoption of filing-office rules. — The Secretary of State shall adopt and publish rules to implement the Secretary of State's responsibilities under this Part. The filing-office rules must be consistent with this Article.

(b) Harmonization of rules. — To keep the filing-office rules and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions that enact substantially this Part, and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions that enact substantially this Part, the Secretary of State, so far as is consistent with the purposes, policies, and provisions of this Article, in adopting, amending, and repealing filing-office rules, may:

(1) Consult with filing offices in other jurisdictions that enact substantially this Part;

(2) Consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators or any successor organization; and

(3) Take into consideration the rules and practices of, and the technology used by, filing offices in other jurisdictions that enact substantially this Part. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New; subsection (b) derives in part from the Uniform Consumer Credit Code (1974).

2. **Rules Required.** Operating a filing office is a complicated business, requiring many more rules and procedures than this article can usefully provide. Subsection (a) requires the adoption of rules to carry out the provisions of article 9. The filing office rules must be consistent with the provisions of the statute and adopted in accordance with local procedures. The publication requirement informs secured parties about filing office practices, aids secured parties in evaluating filing-related risks and costs, and promotes regularity of application within the filing office.

3. **Importance of Uniformity.** In today's national economy, uniformity of the policies and practices of the filing offices will reduce the costs of secured transactions substantially. The International Association of Corporate Administrators (IACA), referred to in subsection (b), is an organization whose membership includes filing officers from every state. These individuals are responsible for the proper functioning of the article 9 filing system and have worked diligently to develop model filing office rules, with a view toward efficiency and uniformity.

Although uniformity is an important desideratum, subsection (a) affords considerable flexibility in the adoption of filing office rules. Each state may adopt a version of subsection (a) that reflects the desired relationship between the statewide filing office described in section 9-501(a)(2) and the local filing offices described in section 9-501(a)(1) and that takes into account the practices of its filing offices. Subsection (a) need not designate a single official or agency to adopt rules applicable to all filing offices, and the rules applicable to the statewide filing office need not be identical to those applicable to the local filing office. For example, subsection (a) might provide for the statewide filing office to adopt filing office rules, and, if not prohibited by other law, the filing office might adopt one set of rules for itself and another for local offices. Or, subsection (a) might designate one official or agency to adopt rules for the statewide filing office and another to adopt rules for local filing offices.

NORTH CAROLINA COMMENT

Subsection (a) is modified by changing "this Article" to "the Secretary of State's responsibilities under this Part" and by deleting subdivision (a)(2). Subsection (b) is modified by changing "shall" to "may."

§ 25-9-527: Reserved for future codification purposes.

NORTH CAROLINA COMMENT

Section 9-527 of the uniform text (duty to report) is omitted.

PART 6.

DEFAULT.

Subpart 1. Default and Enforcement of Security Interest.

§ 25-9-601. Rights after default; judicial enforcement; consignor or buyer of accounts, chattel paper, payment intangibles, or promissory notes.

(a) Rights of secured party after default. — After default, a secured party has the rights provided in this Part and, except as otherwise provided in G.S. 25-9-602, those provided by agreement of the parties. A secured party:

(1) May reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and

(2) If the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) Rights and duties of secured party in possession or control. — A secured party in possession of collateral or control of collateral under G.S. 25-7-106, 25-9-104, 25-9-105, 25-9-106, or 25-9-107 has the rights and duties provided in G.S. 25-9-207.

(c) Rights cumulative; simultaneous exercise. — The rights under subsections (a) and (b) of this section are cumulative and may be exercised simultaneously.

(d) Rights of debtor and obligor. — Except as otherwise provided in subsection (g) of this section and G.S. 25-9-605, after default, a debtor and an obligor have the rights provided in this Part and by agreement of the parties.

(e) Lien of levy after judgment. — If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

(1) The date of perfection of the security interest or agricultural lien in the collateral;

(2) The date of filing a financing statement covering the collateral; or

(3) Any date specified in a statute under which the agricultural lien was created.

(f) Execution sale. — A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this Article.

(g) Consignor or buyer of certain rights to payment. — Except as otherwise provided in G.S. 25-9-607(c), this Part imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes. (1866-7, c. 1, s. 2; 1872-3, c. 133, s. 2; 1883, c. 88; Code, s. 1800; 1893, c. 9; Rev., s. 2054; C.S., s. 2488; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1; 2006-112, s. 55.)

OFFICIAL COMMENT

1. **Source.** Former section 9-501(1), (2), (5).

2. **Enforcement: In General.** The rights of a secured party to enforce its security interest in collateral after the debtor's default are an important feature of a secured transaction. (Note that the term "rights," as defined in section 1-201, includes "remedies.") This part provides those rights as well as certain limitations on their exercise for the protection of the defaulting debtor, other creditors, and other affected persons. However, subsections (a) and (d) make clear that the rights provided in this part do not exclude other rights provided by agreement.

3. **When Remedies Arise.** Under subsection (a) the secured party's rights arise "(a)fter default." As did former section 9-501, this article leaves to the agreement of the parties the circumstances giving rise to a default. This article does not determine whether a secured party's post-default conduct can constitute a waiver of default in the face of an agreement stating that such conduct shall not constitute a waiver. Rather, it continues to leave to the parties' agreement, as supplemented by law other than this article, the determination whether a default has occurred or has been waived. See section 1-103.

4. **Possession of Collateral; Section 9-207.** After a secured party takes possession of collateral following a default, there is no longer any distinction between a security interest that before default was nonpossessory and a security interest that was possessory before default, as under a common-law pledge. This part generally does not distinguish between the rights of a secured party with a nonpossessory security interest and those of a secured party with a possessory security interest. However, section 9-207 addresses rights and duties with respect to collateral in a secured party's possession. Under subsection (b) of this section, section 9-207 applies not only to possession before default but also to possession after default. Subsection (b) also has been conformed to section 9-207, which, unlike former section 9-207, applies to secured parties having control of collateral.

5. **Cumulative Remedies.** Former section 9-501(1) provided that the secured party's remedies were cumulative, but it did not explicitly provide whether the remedies could be exercised simultaneously. Subsection (c) permits the simultaneous exercise of remedies if the secured party acts in good faith. The liability scheme of subpart 2 affords redress to an aggrieved debtor or obligor. Moreover, permitting the simultaneous exercise of remedies under subsection (c) does not override any non-UCC law, including the law of tort and statutes regulating collection of debts, under which the simultaneous exercise of remedies in a particular case constitutes abusive behavior or harassment giving rise to liability.

6. **Judicial Enforcement.** Under subsection (a) a secured party may reduce its claim to judgment or foreclose its interest by any available procedure outside this article under applicable law. Subsection (e) generally follows former section 9-501(5). It makes clear that any judicial lien that the secured party may acquire against the collateral effectively is a continuation of the original security interest (if perfected) and not the acquisition of a new interest or a transfer of property on account of a preexisting obligation. Under former section 9-501(5), the judicial lien was stated to relate back to the date of perfection of the security interest. Subsection (e), however, provides that the lien relates back to the earlier of the date of filing or the date of perfection. This provides a secured party who enforces a security interest by judicial process with the benefit of the "first-to-file-or-perfect" priority rule of section 9-322(a)(1).

7. **Agricultural Liens.** Part 6 provides parallel treatment for the enforcement of agricultural liens and security interests. Because agricultural liens are statutory rather than consensual, this article does draw a few distinctions between these liens and security interests. Under subsection (e), the statute creating an agricultural lien would govern whether and the date to which an execution lien relates back. Section 9-606 explains when a "default" occurs in the agricultural lien context.

8. **Execution Sales.** Subsection (f) also follows former section 9-501(5). It makes clear that an execution sale is an appropriate method of foreclosure contemplated by this part. How-

ever, the sale is governed by other law and not by this article, and the limitations under section 9-610 on the right of a secured party to purchase collateral do not apply.

9. **Sales of Receivables; Consignments.** Subsection (g) provides that, except as provided in section 9-607(c), the duties imposed on secured parties do not apply to buyers of accounts, chattel paper, payment intangibles, or promissory notes. Although denominated "secured parties," these buyers own the entire interest in the property sold and so may enforce their rights without regard to the seller ("debtor") or the seller's creditors. Likewise, a true consignor may enforce its ownership interest under other law without regard to the duties that this part imposes on secured parties. Note, however, that section 9-615 governs cases in which a consignee's secured party (other than a consignor) is enforcing a security interest that is senior to the security interest (i.e., ownership interest) of a true consignor.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Effect of Amendments. — Session Laws 2006-112, s. 55, effective October 1, 2006, inserted "25-7-106" in subsection (b).

Legal Periodicals. — For survey of 1979 commercial law, see 58 N.C.L. Rev. 1290 (1980).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Rights and remedies under former G.S. 25-9-501 were cumulative; therefore there was no double recovery by a creditor who was awarded a money judgment after having already repossessed debtor's car, because the car was worthless. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

In an action regarding the purchase and sale of a business, in which the sellers counterclaimed on a promissory note executed by the buyer, given the buyer's default, the sellers were entitled to elect both possession of the collateral and a judgment for the amount owed, under G.S. 25-9-601(a)(1) and (c), as their rights on default were cumulative. Kindred of N.C., Inc. v. Bond, 160 N.C. App. 90, 584 S.E.2d 846, 2003 N.C. App. LEXIS 1765 (2003).

No Obligation to Take Possession Upon Demand of Debtor. — The right of the secured party to take possession of the collateral does not impose an obligation to take possession upon demand of the debtor. North Carolina Nat'l Bank v. Sharpe, 35 N.C. App. 404, 241 S.E.2d 360 (1978).

Seller Entitled to VCR. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good, plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Debtor's Failure to Make Household Goods Exemption Election under § 1C-1601. — When debtor failed to make an election for an exemption under G.S. 1C-1601, allowing debtor to retain $2,500 worth of household goods and furnishings free from judgment, there was no unfair or deceptive practice on the part of a creditor who took a nonpossessory, nonpurchase money security interest in debtor's household goods and furnishings, even if creditor failed to inform debtor that such an exemption was available. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

Because an exemption for household goods and furnishings is available at the election of a borrower, borrower's property is subject to creditor's action for repossession if borrower does not make the election, even if value of goods is listed on a security agreement. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

As to former summary proceeding to enforce agricultural lien, see Thomas v. Campbell, 74 N.C. 787 (1876); Gray v. Nash, 84 N.C. 334 (1881); Cottingham & Bros. v. McKay, 86 N.C. 241 (1882).

Commercial Reasonableness. — When a creditor which had contracted with an auctioneer to sell a defaulting debtor's collateral transferred its rights to another, which entered into a second contract with the auctioneer, the fact that the second contract was less favorable than the first to a guarantor's rights against the debtor did not render its terms commercially unreasonable, under G.S. 25-9-109, G.S. 25-9-615(a)(1), or G.S. 25-9-610(b), because there was sufficient evidence that a presumptively reasonable public sale was held, and the guarantor did not have standing as an intended third-party beneficiary of the first contract to enforce it. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-602. Waiver and variance of rights and duties.

Except as otherwise provided in G.S. 25-9-624, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections:

(1) G.S. 25-9-207(b)(4)c., which deals with use and operation of the collateral by the secured party;
(2) G.S. 25-9-210, which deals with requests for an accounting and requests concerning a list of collateral and statement of account;
(3) G.S. 25-9-607(c), which deals with collection and enforcement of collateral;
(4) G.S. 25-9-608(a) and G.S. 25-9-615(c) to the extent that they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;
(5) G.S. 25-9-608(a) and G.S. 25-9-615(d) to the extent that they require accounting for or payment of surplus proceeds of collateral;
(6) G.S. 25-9-609 to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;
(7) G.S. 25-9-610(b), 25-9-611, 25-9-613, and 25-9-614, which deal with disposition of collateral;
(8) G.S. 25-9-615(f), which deals with calculation of a deficiency or surplus when a disposition is made to the secured party, a person related to the secured party, or a secondary obligor;
(9) G.S. 25-9-616, which deals with explanation of the calculation of a surplus or deficiency;
(10) G.S. 25-9-620, 25-9-621, and 25-9-622, which deal with acceptance of collateral in satisfaction of obligation;
(11) G.S. 25-9-623, which deals with redemption of collateral;
(12) G.S. 25-9-624, which deals with permissible waivers; and
(13) G.S. 25-9-625 and G.S. 25-9-626, which deal with the secured party's liability for failure to comply with this Article. (1866-7, c. 1, s. 2; 1872-3, c. 133, s. 2; 1883, c. 88; Code, s. 1800; 1893, c. 9; Rev., s. 2054; C.S., s. 2488; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-501(3).

2. **Waiver: In General.** Section 1-102(3) addresses which provisions of the UCC are mandatory and which may be varied by agreement. With exceptions relating to good faith, diligence, reasonableness, and care, immediate parties, as between themselves, may vary its provisions by agreement. However, in the context of rights and duties after default, our legal system traditionally has looked with suspicion on agreements that limit the debtor's rights and free the secured party of its duties. As stated in former section 9-501, comment 4, "no mortgage clause has ever been allowed to clog the equity of redemption." The context of default offers great opportunity for overreaching. The suspicious attitudes of the courts have been grounded in common sense. This section, like former section 9-501(3), codifies this longstanding and deeply rooted attitude. The specified rights of the debtor and duties of the secured party may not be waived or varied except as stated. Provisions that are not specified in this section are subject to the general rules in section 1-102(3).

3. **Nonwaivable Rights and Duties.** This section revises former section 9-501(3) by restricting the ability to waive or modify additional specified rights and duties: (i) Duties under section 9-207(b)(4)(C), which deals with the use and operation of consumer goods; (ii) the right to a response to a request for an accounting, concerning a list of collateral, or concerning a statement of account (section 9-210); (iii) the duty to collect collateral in a commercially reasonable manner (section 9-607); (iv) the implicit duty to refrain from a breach of the peace in taking possession of collateral under section 9-609; (v) the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (sections 9-608 and 9-615); (vi) the right to a special method of calculating a surplus or deficiency in certain dispositions to a secured party, a person related to secured party, or a secondary obligor (section 9-615); (vii) the duty to give an explanation of the calculation of a surplus or deficiency (section 9-616); (viii) the right to limitations on the effectiveness of certain waivers (section 9-624); and (ix) the right to hold a secured party liable for failure to comply with this article (sections 9-625 and 9-626). For clarity and consistency, this article uses the term "waive or vary" instead of "renounc[e] or modify[ ]," which appeared in former section 9-504(3).

This section provides generally that the specified rights and duties "may not be waived or varied." However, it does not restrict the ability of parties to agree to settle, compromise, or renounce claims for past conduct that may have constituted a violation or breach of those rights and duties, even if the settlement involves an express "waiver."

4. **Waiver by Debtors and Obligors.** The restrictions on waiver contained in this section apply to obligors as well as debtors. This resolves a question under former article 9 as to whether secondary obligors, assuming that they were "debtors" for purposes of former part 5, were permitted to waive, under the law of suretyship, rights and duties under that part.

5. **Certain Post-Default Waivers.** Section 9-624 permits post-default waivers in limited circumstances. These waivers must be made in agreements that are authenticated. Under section 1-201, an "'agreement' means the bargain of the parties in fact." In considering waivers under section 9-624 and analogous agreements in other contexts, courts should carefully scrutinize putative agreements that appear in records that also address many additional or unrelated matters.

§ 25-9-603. Agreement on standards concerning rights and duties.

(a) Agreed standards. — The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in G.S. 25-9-602 if the standards are not manifestly unreasonable.

(b) Agreed standards inapplicable to breach of peace. — Subsection (a) of this section does not apply to the duty under G.S. 25-9-609 to refrain from breaching the peace. (1866-7, c. 1, s. 2; 1872-3, c. 133, s. 2; 1883, c. 88; Code, s. 1800; 1893, c. 9; Rev., s. 2054; C.S., s. 2488; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-501(3).

2. **Limitation on Ability to Set Standards.** Subsection (a), like former section 9-501(3), permits the parties to set standards for compliance with the rights and duties under this part if the standards are not "manifestly unreasonable." Under subsection (b), the parties are not permitted to set standards measuring fulfillment of the secured party's duty to take collateral without breaching the peace.

§ 25-9-604. Procedure if security agreement covers real property or fixtures.

(a) Enforcement: personal and real property. — If a security agreement covers both personal and real property, a secured party may proceed:

(1) Under this Part as to the personal property without prejudicing any rights with respect to the real property; or

(2) As to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this Part do not apply.

(b) Enforcement: fixtures. — Subject to subsection (c) of this section, if a security agreement covers goods that are or become fixtures, a secured party may proceed:

(1) Under this Part; or

(2) In accordance with the rights with respect to real property, in which case the other provisions of this Part do not apply.

(c) Removal of fixtures. — Subject to the other provisions of this Part, if a secured party holding a security interest in fixtures has priority over all owners and encumbrancers of the real property, the secured party, after default, may remove the collateral from the real property.

(d) Injury caused by removal. — A secured party that removes collateral shall promptly reimburse any encumbrancer or owner of the real property, other than the debtor, for the cost of repair of any physical injury caused by the removal. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the real property caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-313(8) and 9-501(4).

2. **Real-Property-Related Collateral.** The collateral in many transactions consists of both real and personal property. In the interest of simplicity, speed, and economy, subsection (a), like former section 9-501(4), permits (but does not require) the secured party to proceed as to both real and personal property in accordance with its rights and remedies with respect to the real property. Subsection (a) also makes clear that a secured party who exercises rights under part 6 with respect to personal property does not prejudice any rights under real-property law.

This article does not address certain other real-property-related problems. In a number of states, the exercise of remedies by a creditor who is secured by both real property and non-real property collateral is governed by special legal rules. For example, under some antideficiency laws, creditors risk loss of rights against personal property collateral if they err in enforcing their rights against the real property. Under a "one-form-of-action" rule (or rule against splitting a cause of action), a creditor who judicially enforces a real property mortgage and does not proceed in the same action to enforce a security interest in personalty may (among other consequences) lose the right to proceed against the personalty. Although statutes of this kind create impediments to enforcement of security interests, this article does not override these limitations under other law.

3. **Fixtures.** Subsection (b) is new. It makes clear that a security interest in fixtures may be

enforced either under real property law or under any of the applicable provisions of part 6, including sale or other disposition either before or after removal of the fixtures (see subsection (c)). Subsection (b) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real property. See, e.g., Maplewood Bank & Trust v. Sears, Roebuck & Co., 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

Subsection (c) generally follows former section 9-313(8). It gives the secured party the right to remove fixtures under certain circumstances. A secured party whose security interest in fixtures has priority over owners and encumbrancers of the real property may remove the collateral from the real property. However, subsection (d) requires the secured party to reimburse any owner (other than the debtor) or encumbrancer for the cost of repairing any physical injury caused by the removal. This right to reimbursement is implemented by the last sentence of subsection (d), which gives the owner or encumbrancer a right to security or indemnity as a condition for giving permission to remove.

§ 25-9-605. Unknown debtor or secondary obligor.

A secured party does not owe a duty based on its status as secured party:

(1) To a person that is a debtor or obligor, unless the secured party knows:
  a. That the person is a debtor or obligor;
  b. The identity of the person; and
  c. How to communicate with the person; or

(2) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:
  a. That the person is a debtor; and
  b. The identity of the person. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Duties to Unknown Persons.** This section relieves a secured party from duties owed to a debtor or obligor, if the secured party does not know about the debtor or obligor. Similarly, it relieves a secured party from duties owed to a secured party or lienholder who has filed a financing statement against the debtor, if the secured party does not know about the debtor. For example, a secured party may be unaware that the original debtor has sold the collateral subject to the security interest and that the new owner has become the debtor. If so, the secured party owes no duty to the new owner (debtor) or to a secured party who has filed a financing statement against the new owner. This section should be read in conjunction with the exculpatory provisions in section 9-628. Note that it relieves a secured party not only from duties arising under this article but also from duties arising under other law by virtue of the secured party's status as such under this article, unless the other law otherwise provides.

§ 25-9-606. Time of default for agricultural lien.

For purposes of this Part, a default occurs in connection with an agricultural lien at the time the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Time of Default.** Remedies under this part become available upon the debtor's "default." See section 9-601. This section explains when "default" occurs in the agricultural-lien context. It requires one to consult the enabling statute to determine when the lienholder is entitled to enforce the lien.

§ 25-9-607. Collection and enforcement by secured party.

(a) Collection and enforcement generally. — If so agreed, and in any event after default, a secured party:

(1) May notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;

(2) May take any proceeds to which the secured party is entitled under G.S. 25-9-315;

(3) May enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral;

(4) If it holds a security interest in a deposit account perfected by control under G.S. 25-9-104(a)(1), may apply the balance of the deposit account to the obligation secured by the deposit account; and

(5) If it holds a security interest in a deposit account perfected by control under G.S. 25-9-104(a)(2) or (a)(3), may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(b) Nonjudicial enforcement of mortgage. — If necessary to enable a secured party to exercise under subdivision (a)(3) of this section the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

(1) A copy of the security agreement that creates or provides for a security interest in the obligation secured by the mortgage; and

(2) The secured party's sworn affidavit in recordable form stating that:

  a. A default has occurred; and

  b. The secured party is entitled to enforce the mortgage nonjudicially.

(c) Commercially reasonable collection and enforcement. — A secured party shall proceed in a commercially reasonable manner if the secured party:

(1) Undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and

(2) Is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(d) Expenses of collection and enforcement. — A secured party may deduct from the collections made pursuant to subsection (c) of this section reasonable expenses of collection and enforcement, including reasonable attorney's fees and legal expenses incurred by the secured party.

(e) Duties to secured party not affected. — This section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-502; subsections (b), (d), and (e) are new.

2. **Collections:** In General. Collateral consisting of rights to payment is not only the most liquid asset of a typical debtor's business but also is property that may be collected without any interruption of the debtor's business. This situation is far different from that in which collateral is inventory or equipment, whose removal may bring the business to a halt. Furthermore, problems of valuation and identification, present with collateral that is tangible personal property, frequently are not as serious in the case of rights to payment and other intangible collateral. Consequently, this section, like former section 9-502, recognizes that financing through assignments of intangibles lacks many of the complexities that arise after default in other types of financing. This section allows the assignee to liquidate collateral by collecting whatever may become due on the collateral, whether or not the method of collection contemplated by the security arrangement before default was direct (i.e., payment by the account debtor to the assignee, "notification" financing) or indirect (i.e., payment by the account debtor to the assignor, "nonnotification" financing).

3. **Scope.** The scope of this section is broader than that of former section 9-502. It applies not only to collections from account debtors and obligors on instruments but also to enforcement more generally against all persons obligated on collateral. It explicitly provides for the secured party's enforcement of the debtor's rights in respect of the account debtor's (and other third parties') obligations and for the secured party's enforcement of supporting obligations with respect to those obligations. (Supporting obligations are components of the collateral under section 9-203(f).) The rights of a secured party under subsection (a) include the right to enforce claims that the debtor may enjoy against others. For example, the claims might include a breach-of-warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under section 9-315.

4. **Collection and Enforcement Before Default.** Like part 6 generally, this section deals with the rights and duties of secured parties following default. However, as did former section 9-502 with respect to collection rights, this section also applies to the collection and enforcement rights of secured parties even if a default has not occurred, as long as the debtor has so agreed. It is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

5. **Collections by Junior Secured Party.** A secured party who holds a security interest in a right to payment may exercise the right to collect and enforce under this section, even if the security interest is subordinate to a conflicting security interest in the same right to payment. Whether the junior secured party has priority in the collected proceeds depends on whether the junior secured party qualifies for priority as a purchaser of an instrument (e.g., the account debtor's check) under section 9-330(d), as a holder in due course of an instrument under sections 3-305 and 9-331(a), or as a transferee of money under section 9-332(a). See sections 9-330, comment 7; 9-331, comment 5; and 9-332.

6. **Relationship to Rights and Duties of Persons Obligated on Collateral.** This section permits a secured party to collect and enforce obligations included in collateral in its capacity as a secured party. It is not necessary for a secured party first to become the owner of the collateral pursuant to a disposition or acceptance. However, the secured party's rights, as between it and the debtor, to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to section 9-341, part 4, and other applicable law. *Neither this section nor former section 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral.* Subsection (e) makes this explicit. For example, the secured party may be unable to exercise the debtor's rights under an instrument if the debtor is in possession of the instrument, or under a nontransferable letter of credit if the debtor is the beneficiary. Unless a secured party has control over a letter-of-credit right and is entitled to receive payment or performance from the issuer or a nominated person under article 5, its remedies with respect to the letter-of-credit right may be limited to the recovery of any identifiable proceeds from the debtor. This section establishes only the baseline rights of the secured party vis-a-vis the debtor—the secured party is entitled to enforce and collect after default or earlier if so agreed.

7. **Deposit Account Collateral.** Subsections (a)(4) and (5) set forth the self-help remedy for a secured party whose collateral is a deposit account. Subsection (a)(4) addresses the rights of a secured party that is the bank with which the deposit account is maintained. That secured party automatically has control of the deposit account under section 9-104(a)(1). After default, and otherwise if so agreed, the bank/secured party may apply the funds on deposit to the secured obligation.

If a security interest of a third party is perfected by control (section 9-104(a)(2) or (a)(3)), then after default, and otherwise if so agreed, the secured party may instruct the bank to pay out the funds in the account. If the third party has control under section 9-104(a)(3), the depositary institution is obliged to obey the instruction because the secured party is its customer. See section 4-401. If the third party has control under section 9-104(a)(2), the control agreement determines the depositary institution's obligation to obey.

If a security interest in a deposit account is unperfected, or is perfected by filing by virtue of the proceeds rules of section 9-315, the depositary institution ordinarily owes no obligation to obey the secured party's instructions. See section 9-341. To reach the funds without the debtor's cooperation, the secured party must use an available judicial procedure.

8. **Rights Against Mortgagor of Real Property.** Subsection (b) addresses the situation in which the collateral consists of a mortgage note (or other obligation secured by a mortgage on real property). After the debtor's (mortgagee's) default, the secured party (assignee) may wish to proceed with a nonjudicial foreclosure of the mortgage securing the note but may be unable to do so because it has not become the assignee of record. The assignee/secured party may not have taken a recordable assignment at the commencement of the transaction (perhaps the mortgage note in question

was one of hundreds assigned to the secured party as collateral). Having defaulted, the mortgagee may be unwilling to sign a recordable assignment. This section enables the secured party (assignee) to become the assignee of record by recording in the applicable real property records the security agreement and an affidavit certifying default. Of course, the secured party's rights derive from those of its debtor. Subsection (b) would not entitle the secured party to proceed with a foreclosure unless the mortgagor also were in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose.

9. **Commercial Reasonableness.** Subsection (c) provides that the secured party's collection and enforcement rights under subsection (a) must be exercised in a commercially reasonable manner. These rights include the right to settle and compromise claims against the account debtor. The secured party's failure to observe the standard of commercial reasonableness could render it liable to an aggrieved person under section 9-625, and the secured party's recovery of a deficiency would be subject to section 9-626. Subsection (c) does not apply if, as is characteristic of most sales of accounts, chattel paper, payment intangibles, and promissory notes, the secured party (buyer) has no right of recourse against the debtor (seller) or a secondary obligor. However, if the secured party does have a right of recourse, the commercial reasonableness standard applies to collection and enforcement even though the assignment to the secured party was a "true" sale. The obligation to proceed in a commercially reasonable manner arises because the collection process affects the extent of the seller's recourse liability, not because the seller retains an interest in the sold collateral (the seller does not). Concerning classification of a transaction, see Section 9-109, Comment 4.

10. **Attorney's Fees and Legal Expenses.** The phrase "reasonable attorney's fees and legal expenses," which appears in subsection (d), includes only those fees and expenses incurred in proceeding against account debtors or other third parties. The secured party's right to recover these expenses from the collections arises automatically under this section. The secured party also may incur other attorney's fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorney's fees and legal expenses under sections 9-608(a)(1)(A) and 9-615(a)(1). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (d) or section 9-608(a).

CASE NOTES

Editor's Note. *— The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Burden on Secured Party Seeking Deficiency Judgment. — A secured party seeking a deficiency judgment under former G.S. 25-9-502 had the burden of establishing compliance with the twin duties of reasonable notification and commercially reasonable disposition. Placing the burden of persuasion on the secured party tends to insure that the deficiency sought has not been unnecessarily enhanced by abuses of the broad discretion accorded the secured party with respect to the disposition of collateral. North Carolina Nat'l Bank v. Burnette, 297 N.C. 524, 256 S.E.2d 388 (1979); Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-608. Application of proceeds of collection or enforcement; liability for deficiency and right to surplus.

(a) Application of proceeds, surplus, and deficiency if obligation secured. — If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

(1) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under G.S. 25-9-607 in the following order to:

a. The reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

b. The satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and

c. The satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under sub-subdivision (a)(1)c. of this section.

(3) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under G.S. 25-9-607 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

(b) No surplus or deficiency in sales of certain rights to payment. — If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes, the debtor is not entitled to any surplus, and the obligor is not liable for any deficiency. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Subsection (a) is new; subsection (b) derives from former section 9-502(2).

2. **Modifications of Prior Law.** Subsections (a) and (b) modify former section 9-502(2) by explicitly providing for the application of proceeds recovered by the secured party in substantially the same manner as provided in section 9-615(a) and (e) for dispositions of collateral.

3. **Surplus and Deficiency.** Subsections (a)(4) and (b) omit, as unnecessary, the references contained in former section 9-502(2) to agreements varying the baseline rules on surplus and deficiency. The parties are always free to agree that an obligor will not be liable for a deficiency, even if the collateral secures an obligation, and that an obligor is liable for a deficiency, even if the transaction is a sale of receivables. For parallel provisions, see section 9-615(d) and (e).

4. **Noncash Proceeds.** Subsection (a)(3) addresses the situation in which an enforcing secured party receives noncash proceeds.

Example: An enforcing secured party receives a promissory note from an account debtor who is unable to pay an account when it is due. The secured party accepts the note in exchange for extending the date on which the account debtor's obligation is due. The secured party may wish to credit its debtor (the assignor) with the principal amount of the note upon receipt of the note, but probably will prefer to credit the debtor only as and when the note is paid.

Under subsection (a)(3), the secured party is under no duty to apply the note or its value to the outstanding obligation unless its failure to do so would be commercially unreasonable. If the secured party does apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the method of application of noncash proceeds by agreement, if the method is not manifestly unreasonable. See section 9-603. This section does not explain when the failure to apply noncash proceeds would be commercially unreasonable; it leaves that determination to case-by-case adjudication. In the example, the secured party appears to have accepted the account debtor's note in order to increase the likelihood of payment and decrease the likelihood that the account debtor would dispute its obligation. Under these circumstances, it may well be commercially reasonable for the secured party to credit its debtor's obligations only as and when cash proceeds are collected from the account debtor, especially given the uncertainty that attends the account debtor's eventual payment. For an example of a secured party's receipt of noncash proceeds in which it may well be commercially unreasonable for the secured party to delay crediting its debtor's obligations with the value of noncash proceeds, see section 9-615, comment 3.

When the secured party is not required to "apply or pay over for application noncash proceeds," the proceeds nonetheless remain collateral subject to this article. If the secured party were to dispose of them, for example, appropriate notification would be required (see section 9-611), and the disposition would be subject to the standards provided in this part (see section 9-610). Moreover, a secured party in possession of the noncash proceeds would have the duties specified in section 9-207.

5. **No Effect on Priority of Senior Security Interest.** The application of proceeds required by subsection (a) does not affect the priority of a security interest in collateral which is senior to the interest of the secured party who is collecting or enforcing collateral under section 9-607. Although subsection (a) imposes a duty to apply proceeds to the enforcing secured party's expenses and to the satisfaction of the secured obligations owed to it and to subordinate secured parties, that duty applies only among the enforcing secured party and those persons. Concerning the priority of a junior secured party who collects and enforces collateral, see section 9-607, comment 5.

§ 25-9-609. Secured party's right to take possession after default.

(a) Possession; rendering equipment unusable; disposition on debtor's premises. — After default, a secured party:

(1) May take possession of the collateral; and

(2) Without removal, may render equipment unusable and dispose of collateral on a debtor's premises under G.S. 25-9-610.

(b) Judicial and nonjudicial process. — A secured party may proceed under subsection (a) of this section:

(1) Pursuant to judicial process; or

(2) Without judicial process, if it proceeds without breach of the peace.

(c) Assembly of collateral. — If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-503.

2. **Secured Party's Right to Possession.** This section follows former section 9-503 and earlier uniform legislation. It provides that the secured party is entitled to take possession of collateral after default.

3. **Judicial Process; Breach of Peace.** Subsection (b) permits a secured party to proceed under this section without judicial process if it does so "without breach of the peace." Although former section 9-503 placed the same condition on a secured party's right to take possession of collateral, subsection (b) extends the condition to the right provided in subsection (a)(2) as well. Like former section 9-503, this section does not define or explain the conduct that will constitute a breach of the peace, leaving that matter for continuing development by the courts. In considering whether a secured party has engaged in a breach of the peace, however, courts should hold the secured party responsible for the actions of others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of collateral.

This section does not authorize a secured party who repossesses without judicial process to utilize the assistance of a law enforcement officer. A number of cases have held that a repossessing secured party's use of a law enforcement officer without benefit of judicial process constituted a failure to comply with former section 9-503.

4. **Damages for Breach of Peace.** Concerning damages that may be recovered based on a secured party's breach of the peace in connection with taking possession of collateral, see section 9-625, comment 3.

5. **Multiple Secured Parties.** More than one secured party may be entitled to take possession of collateral under this section. Conflicting rights to possession among secured parties are resolved by the priority rules of this article. Thus, a senior secured party is entitled to possession as against a junior claimant. Non-UCC law governs whether a junior secured party in possession of collateral is liable to the senior in conversion. Normally, a junior

who refuses to relinquish possession of collateral upon the demand of a secured party having a superior possessory right to the collateral would be liable in conversion.

6. **Secured Party's Right to Disable and Dispose of Equipment on Debtor's Premises.** In the case of some collateral, such as heavy equipment, the physical removal from the debtor's plant and the storage of the collateral pending disposition may be impractical or unduly expensive. This section follows former section 9-503 by providing that, in lieu of removal, the secured party may render equipment unusable or may dispose of collateral on the debtor's premises. Unlike former section 9-503, however, this section explicitly conditions these rights on the debtor's default. Of course, this section does not validate unreasonable action by a secured party. Under section 9-610, all aspects of a disposition must be commercially reasonable.

7. **Debtor's Agreement to Assemble Collateral.** This section follows former section 9-503 also by validating a debtor's agreement to assemble collateral and make it available to a secured party at a place that the secured party designates. Similar to the treatment of agreements to permit collection prior to default under section 9-607 and former section 9-502, however, this section validates these agreements whether or not they are conditioned on the debtor's default. For example, a debtor might agree to make available to a secured party, from time to time, any instruments or negotiable documents that the debtor receives on account of collateral. A court should not infer from this section's validation that a debtor's agreement to assemble and make available collateral would not be enforceable under other applicable law.

8. **Agreed Standards.** Subject to the limitation imposed by section 9-603(b), this section's provisions concerning agreements to assemble and make available collateral and a secured party's right to disable equipment and dispose of collateral on a debtor's premises are likely topics for agreement on standards as contemplated by section 9-603.

Legal Periodicals. — For comment, "The Standard of Commercial Reasonableness in the Sale of Repossessed Collateral by Secured Creditors in North Carolina," see 15 Wake Forest L. Rev. 71 (1979).

For note on the non-purchase security agreement as a relinquishment of the personal property exemption, see 15 Wake Forest L. Rev. 708 (1979).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Statute Is Self-Executing. — Former G.S. 25-9-503 (see now G.S. 25-9-609), allowing self-help repossessions by secured parties, is wholly self-executing and takes no involvement by any state employee to fully effect its purpose; in enacting the section, the General Assembly codified a right existing at common law, and it did not delegate to private parties authority previously held by the State. Giles v. First Va. Credit Servs., Inc., 149 N.C. App. 89, 560 S.E.2d 557, 2002 N.C. App. LEXIS 127 (2002), cert denied, 355 N.C. 491, 563 S.E.2d 568 (2002).

Landlord Perfecting Security Interest by Taking Possession Has Priority over Selling Company. — In an action to determine the right of possession to a piece of property as between a landlord under a lease agreement and a company who sold the property under a conditional sales contract, neither party having filed a financing statement, the landlord, who perfected its security interest under the lease by taking possession of the property, has priority over the selling company. Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970).

No Obligation to Take Possession upon Demand of Debtor. — The right of the secured party to take possession of the collateral does not impose an obligation to take possession upon demand of the debtor. North Carolina Nat'l Bank v. Sharpe, 35 N.C. App. 404, 241 S.E.2d 360 (1978).

Right to Take Possession of Collateral Otherwise Exempt from Execution. — The legislature has seen fit to surround the family home with certain protection against the demands of urgent creditors to put it beyond the reach of those financial misfortunes which even the most prudent and sagacious cannot always avoid. It has not seen fit to prevent a debtor from "selling" or otherwise transferring an interest in that property to another, thereby giving the other priority of right to possession of the collateral. The constitutional exemption operates against general creditors so as to allow the debtor to retain his most valued

$500.00 of property in the face of their executions. It does not operate so as to hinder secured creditors from realizing on the terms of their bargain. Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219, appeal dismissed, 295 N.C. 551, 248 S.E.2d 727 (1978).

In the cases of foreclosure of mortgages or of taking possession of collateral after default, no right to possession of property otherwise exempt remains in the debtor who has voluntarily bargained it away. Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219, appeal dismissed, 295 N.C. 551, 248 S.E.2d 727 (1978).

Debtor divested herself of her right to possession of personal property which might otherwise have been exempt by the terms of her consumer loan contract with her creditor whereby the creditor obtained a security interest in all of her personal property, including her household furnishings. When the debtor defaulted, the creditor had an immediate right to possess all articles in which she had given a security interest. However, this right must be distinguished from any interest which a creditor might seek under an executory waiver of the right to exemption. It has long been held that a debtor cannot be bound by any agreement to waive his exemption in case of levy upon her property. Montford v. Grohman, 36 N.C. App. 733, 245 S.E.2d 219, appeal dismissed, 295 N.C. 551, 248 S.E.2d 727 (1978).

Liability of Debtor for Expense of Retaking Collateral. — A secured party, entitled to possession of collateral upon default by the debtor, may legally require the debtor, upon redemption of the collateral, to pay reasonable expenses incurred in retaking the collateral even though the secured party gave no notice of intention to repossess. Because no such notice is required prior to repossession, the absence of notice does not preclude the secured party from recovering these expenses. Everett v. U.S. Life Credit Corp., 74 N.C. App. 142, 327 S.E.2d 269, modified on other grounds, 314 N.C. 113, 332 S.E.2d 480 (1985).

Ownership of Repossessed Collateral in Bankruptcy. — Until a creditor disposes of the repossessed property, the debtor remains the legal and equitable owner, subject only to the creditor's debt collection remedies, which are suspended by 11 U.S.C.S. § 362(a) when a bankruptcy petition is filed; where a Chapter 13 debtor's vehicle was repossessed prior to debtor filing his bankruptcy petition, debtor retained ownership of the repossessed vehicle and the vehicle automatically became part of the bankruptcy estate when debtor filed his petition. In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

Where there is confrontation at the time of the attempted repossession, the secured party must cease the attempted repossession and proceed by court action in order to avoid a "breach of the peace." Everett v. U.S. Life Credit Corp., 74 N.C. App. 142, 327 S.E.2d 269, modified on other grounds, 314 N.C. 113, 332 S.E.2d 480 (1985).

Balancing Test to Determine Breach of the Peace. — A breach of the peace, in the context of a self-help repossession under former G.S. 25-9-503 (see now G.S. 25-9-609), is broader than the criminal law definition, and a confrontation is not always required; a breach of the peace analysis should be based upon the reasonableness of the time and manner of the repossession, and a balancing test using the five factors of (1) where the repossession took place, (2) the debtor's express or constructive consent, (3) the reactions of third parties, (4) the type of premises entered, and (5) the creditor's use of deception is adopted to determine whether a breach of the peace occurs when there is no confrontation. Giles v. First Va. Credit Servs., Inc., 149 N.C. App. 89, 560 S.E.2d 557, 2002 N.C. App. LEXIS 127 (2002), cert denied, 355 N.C. 491, 563 S.E.2d 568 (2002).

Seller Entitled to VCR. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good, plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

§ 25-9-610. Disposition of collateral after default.

(a) Disposition after default. — After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) Commercially reasonable disposition. — Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) Purchase by secured party. — A secured party may purchase collateral:

(1) At a public disposition; or

(2) At a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) Warranties on disposition. — A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) Disclaimer of warranties. — A secured party may disclaim or modify warranties under subsection (d) of this section:

(1) In a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(2) By communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) Record sufficient to disclaim warranties. — A record is sufficient to disclaim warranties under subsection (e) of this section if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-504(1), (3).

2. **Commercially Reasonable Dispositions.** Subsection (a) follows former section 9-504 by permitting a secured party to dispose of collateral in a commercially reasonable manner following a default. Although subsection (b) permits both public and private dispositions, "every aspect of a disposition . . . must be commercially reasonable." This section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned. Subsection (a) does not restrict dispositions to sales; collateral may be sold, leased, licensed, or otherwise disposed. Section 9-627 provides guidance for determining the circumstances under which a disposition is "commercially reasonable."

3. **Time of Disposition.** This article does not specify a period within which a secured party must dispose of collateral. This is consistent with this article's policy to encourage private dispositions through regular commercial channels. It may, for example, be prudent not to dispose of goods when the market has collapsed. Or, it might be more appropriate to sell a large inventory in parcels over a period of time instead of in bulk. Of course, under subsection (b) every aspect of a disposition of collateral must be commercially reasonable. This requirement explicitly includes the "method, manner, time, place, and other terms." For example, if a secured party does not proceed under section 9-620 and holds collateral for a long period of time without disposing of it, and if there is no good reason for not making a prompt disposition, the secured party may be determined not to have acted in a "commercially reasonable" manner. See also section 1-203 (general obligation of good faith).

4. **Pre-Disposition Preparation and Processing.** Former section 9-504(1) appeared to give the secured party the choice of disposing of collateral either "in its then condition or following any commercially reasonable preparation or processing." Some courts held that the "commercially reasonable" standard of former section 9-504(3) nevertheless could impose an affirmative duty on the secured party to process or prepare the collateral prior to disposition. Subsection (a) retains the substance of the quoted language. Although courts should not be quick to impose a duty of preparation or processing on the secured party, subsection (a) does not grant the secured party the right to dispose of the collateral "in its then condition" under all circumstances. A secured party may not dispose of collateral "in its then condition" when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in that condition.

5. **Disposition by Junior Secured Party.** Disposition rights under subsection (a) are not limited to first-priority security interests. Rather, any secured party as to whom there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest. Section 9-615 addresses application of the proceeds of a disposition by a junior secured party. Under section 9-615(a), a junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of obligations secured by a senior security interest. Section 9-615(g) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a nonarticle 9 claim to proceeds of a junior's disposition, section 9-615(g) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Because the disposition by a junior would not cut off a senior's security interest or other lien (see section 9-617), in many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior.

The holder of a senior security interest is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See section 9-609. The holder of a junior security interest normally must notify the senior secured party of an impending disposition. See section 9-611. Regardless of whether the senior receives a notification from the junior, the junior's disposition does not of itself discharge the senior's security interest. See section 9-617. Unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will survive the disposition by the junior and continue under section 9-315(a)(1). If the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or other lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine "rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." Meyer v. United States, 375 U.S. 233, 236 (1963), quoting Sowell v. Federal Reserve Bank, 268 U.S. 449, 456-57 (1925). The purpose of the doctrine is "to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security." Id. at 237. Because it is an equitable doctrine, marshaling "is applied only when it can be equitably fashioned as to all of the parties" having an interest in the property. Id. This article leaves courts free to determine whether marshaling is appropriate in any given case. See section 1-103.

6. **Security Interests of Equal Rank.** Sometimes two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to "equal and ratable" provisions in indentures, or by operation of law. See section 9-328(6). This article treats a security interest having equal priority like a senior security interest in many respects. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (i) SP-W's and SP-Y's security interests survive the disposition but SP-Z's does not, see section 9-617, and (ii) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds, but SP-Z is. See section 9-615(a)(3).

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See section 9-609, comment 5. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

7. **Public vs. Private Dispositions.** This part maintains two distinctions between "public" and other dispositions: (i) The secured party may buy at the former, but normally not at the latter (section 9-610(c)), and (ii) the debtor is entitled to notification of "the time and place of a public disposition" and notification of "the time after which" a private disposition or other intended disposition is to be made (section 9-613(1)(E)). It does not retain the distinction under former section 9-504(4), under which transferees in a noncomplying public disposition could lose protection more easily than transferees in other noncomplying dispositions. Instead, section 9-617(b) adopts a unitary standard. Although the term is not defined, as used in this article, a "public disposition" is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity" is

meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition).

8. **Investment Property.** Dispositions of investment property may be regulated by the federal securities laws. Although a "public" disposition of securities under this article may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for a "private placement" exemption under the Securities Act of 1933 nevertheless may constitute a "public" disposition within the meaning of this section. Moreover, the "commercially reasonable" requirements of subsection (b) need not prevent a secured party from conducting a foreclosure sale without the issuer's compliance with federal registration requirements.

9. **"Recognized Market."** A "recognized market," as used in subsection (c) and section 9-611(d), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.

10. **Relevance of Price.** While not itself sufficient to establish a violation of this part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable. Note also that even if the disposition is commercially reasonable, section 9-615(f) provides a special method for calculating a deficiency or surplus if (i) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor, and (ii) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

11. **Warranties.** Subsection (d) affords the transferee in a disposition under this section the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of nonarticle 9 law had the disposition been conducted under other circumstances. For example, the article 2 warranty of title would apply to a sale of goods, the analogous warranties of article 2A would apply to a lease of goods, and any common law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d), Contracts section 333 (warranties of assignor).

Subsection (e) explicitly provides that these warranties can be disclaimed either under other applicable law or by communicating a record containing an express disclaimer. The record need not be written, but an oral communication would not be sufficient. See section 9-102 (definition of "record"). Subsection (f) provides a sample of wording that will effectively exclude the warranties in a disposition under this section, whether or not the exclusion would be effective under nonarticle 9 law.

The warranties incorporated by subsection (d) are those relating to "title, possession, quiet enjoyment, and the like." Depending on the circumstances, a disposition under this section also may give rise to other statutory or implied warranties, e.g., warranties of quality or fitness for purpose. Law other than this article determines whether such other warranties apply to a disposition under this section. Other law also determines issues relating to disclaimer of such warranties. For example, a foreclosure sale of a car by a car dealer could give rise to an implied warranty of merchantability (section 2-314) unless effectively disclaimed or modified (section 2-316).

This section's approach to these warranties conflicts with the former comment to section 2-312. This article rejects the baseline assumption that commercially reasonable dispositions under this section are out of the ordinary commercial course or peculiar. The comment to section 2-312 has been revised accordingly.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

For comment, "The Standard of Commercial Reasonableness in the Sale of Repossessed Collateral by Secured Creditors in North Carolina," see 15 Wake Forest L. Rev. 71 (1979).

For note on directed verdicts in favor of the party with the burden of proof, see 16 Wake Forest L. Rev. 607 (1980).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

CASE NOTES

***Editor's Note.** — The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Both Public and Private Sales Authorized. — The UCC specifically authorizes the disposition of collateral by either public or private proceedings. Associates Fin. Servs. Corp. v. Welborn, 269 N.C. 563, 153 S.E.2d 7 (1967).

A provision in a conditional sales contract for private sale of the chattel after default and repossession is not contrary to statute or public policy of this State, and is valid. Associates Fin. Servs. Corp. v. Welborn, 269 N.C. 563, 153 S.E.2d 7 (1967).

A stipulation in a chattel mortgage or conditional sales agreement authorizing the creditor to sell the personal property described therein at private sale violated no statute or public policy of this State. Appliance Buyers Credit Corp. v. Mason, 269 N.C. 567, 153 S.E.2d 3 (1967), decided under § 45-21.38 prior to the 1967 amendment thereto.

In order to recover a deficiency judgment under a conditional sales contract, plaintiff had to allege and prove facts showing (1) that defendant executed and delivered to him or his assignor the contract upon which he sued; (2) that defendant was in default under the terms of the contract; (3) lawful repossession and sale of the property or facts establishing the impossibility of such repossession and sale; (4) the application of the proceeds of the sale; and (5) the amount of the deficiency. Associates Fin. Servs. Corp. v. Welborn, 269 N.C. 563, 153 S.E.2d 7 (1967) (construing § 45-21.38 prior to the 1967 amendment thereto).

A creditor, when suing for a deficiency, has the burden of proving that the disposition of the collateral was conducted in a commercially reasonable manner. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976); Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978); Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

When a secured party seeks a deficiency judgment, it has the burden of establishing compliance with the twin duties of reasonable notification and commercially reasonable disposition. Don Jenkins & Son Ford-Mercury v. Catlette, 59 N.C. App. 482, 297 S.E.2d 409 (1982).

In order to recover a deficiency judgment against a defendant, the burden of proof is on the plaintiff to show the sale of the collateral was commercially reasonable. Parks Chevrolet, Inc. v. Watkins, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

Failure to Conduct Commercially Reasonable Sale Not Absolute Bar to Deficiency Judgment. — A creditor's failure to conduct the sale in a commercially reasonable manner or to give the required notice of the sale is not an absolute bar to obtaining a deficiency judgment. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997), cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997).

Duty of Good Faith in Selling Property. — An authorization in a chattel mortgage or conditional sales agreement permitting a private sale of the personal property does not relieve the mortgagee, in taking possession of and selling the property, from the duty of acting in the utmost good faith. Appliance Buyers Credit Corp. v. Mason, 269 N.C. 567, 153 S.E.2d 3 (1967), decided under § 45-21.38 prior to the 1967 amendment thereto.

Conclusive Presumption of Commercial Reasonableness Created by Compliance. — If the secured creditor disposes of the collateral in a manner in substantial compliance with former Part 6 of this Article, a conclusive presumption of commercial reasonableness was created. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

When a creditor which had contracted with an auctioneer to sell a defaulting debtor's collateral transferred its rights to another, which entered into a second contract with the auctioneer, the fact that the second contract was less favorable than the first to a guarantor's rights against the debtor did not render its terms commercially unreasonable, under G.S. 25-9-109, G.S. 25-9-615(a)(1), or G.S. 25-9-610(b), because there was sufficient evidence that a presumptively reasonable public sale was held, and the guarantor did not have standing as an intended third-party beneficiary of the first contract to enforce it. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

The failure to give notice and/or to dispose of collateral in a commercially reasonable manner results in: (1) a presumption that the collateral was worth at least the amount of the debt; and (2) the amount that could have reasonably been obtained from a commercially reasonable sale of the collateral being credited to the debt. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997), cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997).

Public Sale Conclusively Presumed To Be Commercially Reasonable. — If the secured creditor disposed of the collateral at a public sale as directed in former G.S. 25-9-601 et seq., a conclusive presumption of commercial reasonableness was created. Parks Chevrolet, Inc. v. Watkins, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

But a public sale might be commercially reasonable even though it did not substantially comply with former Part 6 of this Article. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

Absent the establishment of the conclusive presumption of commercial reasonableness, under former Part 6 of this Article, a question of fact remained as to whether the sale was conducted in a commercially reasonable manner. ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

Former § 25-9-507 offered guidance as to what constituted a "commercially reasonable" disposition of collateral. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

Although former G.S. 25-9-504 did not define commercial reasonableness, former G.S. 25-9-507(2) helped in the determination. Don Jenkins & Son Ford-Mercury v. Catlette, 59 N.C. App. 482, 297 S.E.2d 409 (1982).

Burden on Creditor to Prove Commercial Reasonableness. — A creditor, when suing for deficiency judgment, bears the burden of proving that the disposition of the collateral was conducted in a commercially reasonable manner, i.e., reasonable notice and commercially reasonable disposition. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997), cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997).

Commercial reasonableness is a question of fact. Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

Commercial Reasonableness Is Jury Question. — Because reasonable minds may differ over the application of standard such as commercial reasonableness, this determination is inherently a jury question, which does not readily lend itself to summary judgment. Parks Chevrolet, Inc. v. Watkins, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

Absent the establishment of the conclusive presumption through a public sale in compliance with former G.S. 25-9-601 et seq., commercial reasonableness presented a factual issue to be determined by the jury in light of the relevant circumstances of each case. Parks Chevrolet, Inc. v. Watkins, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

Commercial reasonableness is a jury question and does not readily lend itself to summary judgment, as reasonable minds may differ over what is commercially reasonable. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997), cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997).

A commercially reasonable sale is not an absolute bar to successor liability. G.P. Publications, Inc. v. Quebecor Printing - St. Paul, Inc., 125 N.C. App. 424, 481 S.E.2d 674 (1997), cert. denied, 346 N.C. 546, 488 S.E.2d 800 (1997).

"Price" is one of the "terms" of the sale. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978); Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

All Elements of Sale Must Be Considered Together. — There may be cases in which the price paid for the collateral will be commercially reasonable even though a higher price could have been obtained at a different time or in a different market. Nor is a price which is slightly inadequate necessarily commercially unreasonable. The trier of fact must consider all the elements of the sale together. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

When deciding if a sale of repossessed collateral meets the statute, the trier of fact must consider all of the elements of the sale together. Don Jenkins & Son Ford-Mercury v. Catlette, 59 N.C. App. 482, 297 S.E.2d 409 (1982).

Effect of Grossly Inadequate Price. — When the debtor offers independent evidence of a gross inadequacy of price, in North Carolina, that sufficiently raises the issue of the commercial reasonableness of the sale to take the case to the jury. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

Price Actually Received as Evidence of Value of Collateral. — Once the secured party makes a prima facie showing that the sale was otherwise "commercially reasonable," then the price he actually receives for the collateral must be accepted as competent evidence of the value of the collateral and, therefore, as competent evidence that the price was "commercially reasonable." Such evidence is sufficient to withstand defendants' motion for a directed verdict and to take the case to the jury. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

Three factors have been identified to give some guidance in determining the commercial reasonableness of the resale price of collateral: (1) the price reflected by price handbooks, (2) the fair market value of the collateral, and (3) the price received on a second resale. Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

Public Sale Held Valid Despite Absence of Other Bidders. — A lender conducted a valid public sale of a repossessed automobile pursuant to a purchase money security agreement, notwithstanding the fact that no third persons bid at the sale, where the lender duly sent notice to the debtor, and the sale was held as scheduled, at which time any person had the right to enter a bid on the automobile. Under G.S. 25-9-605(1)(a), the sale did not have to be postponed because of the lack of bidders. Therefore, the transaction did not constitute a mere transfer of collateral under former G.S. 25-9-504(5) and defendant dealer had no obligation to account to debtor for any surplus proceeds received through its subsequent resale of the automobile. Shields v. Bobby Murray Chevrolet, Inc., 44 N.C. App. 427, 261 S.E.2d 238, aff'd, 300 N.C. 366, 266 S.E.2d 658 (1980).

Evidence as to Commercial Reasonableness of Resale Held Insufficient. — Where plaintiff made a private resale of repossessed collateral, and presented little evidence as to the manner of the resale other than its statement that plaintiff sold the automobile to a wholesaler, in granting summary judgment for plaintiff the court improperly concluded that the evidence presented was sufficient to establish the commercial reasonableness of the resale as a matter of law. Parks Chevrolet, Inc. v. Watkins, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

A person who is liable to a secured party under a repurchase agreement and takes possession of collateral pursuant to an agreement with the secured party has the rights and duties of a secured party. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Lender's Liability Under Repurchase Agreement. — A lender who repossessed a car and transferred it to a dealer under a repurchase agreement was not liable for the dealer's failure to sell the car within 90 days of repossession as required by former G.S. 25-9-505(1). Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

Guarantor May Waive Right to Commercially Reasonable Disposition of Debtor's Collateral. — While it is true that a debtor may not waive his entitlement to a commercially reasonable disposition of his collateral by a secured creditor, a guarantor may contractually waive his right to a commercially reasonable disposition of the debtor's collateral. Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Dealer's Repossession of Car Did Not Change It to "Inventory." — Where bank recorded a lien on the title of car, plaintiff recorded a second lien on the title of the car and the bank subsequently repossessed the car and assigned its lien on the auto to defendant dealer, defendant assignee did not need to give notice to plaintiff when it sold the car; the car was consumer goods at the time plaintiff entered the finance agreement and the automobile did not become inventory upon dealer's repossession. City Fin. Co. v. Massey Motor Co., 95 N.C. App. 623, 383 S.E.2d 454, cert. denied, 326 N.C. 47, 389 S.E.2d 86 (1990).

Partial Summary Judgment. — When a trial court entered partial summary judgment in favor of an auctioneer suing for its fees from a sale of repossessed collateral, that judgment implicitly found the sale was commercially reasonable under G.S. 25-9-610(b) and G.S. 25-9-615(a)(1), so the judgment was immediately appealable because remaining claims before the trial court also required a determination of commercial reasonableness, creating a risk of inconsistent judgments which could prejudice a guarantor the auctioneer was suing, and that judgment affected a substantial right. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-611. Notification before disposition of collateral.

(a) "Notification date." — In this section, "notification date" means the earlier of the date on which:

(1) A secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(2) The debtor and any secondary obligor waive the right to notification.

(b) Notification of disposition required. — Except as otherwise provided in subsection (d) of this section, a secured party that disposes of collateral under G.S. 25-9-610 shall send to the persons specified in subsection (c) of this section a reasonable authenticated notification of disposition.

(c) Persons to be notified. — To comply with subsection (b) of this section, the secured party shall send an authenticated notification of disposition to:

(1) The debtor;

(2) Any secondary obligor; and

(3) If the collateral is other than consumer goods:

a. Any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

b. Any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

1. Identified the collateral;
2. Was indexed under the debtor's name as of that date; and
3. Was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

c. Any other secured party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in G.S. 25-9-311(a).

(d) Subsection (b) inapplicable: perishable collateral; recognized market. — Subsection (b) of this section does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

(e) Compliance with sub-subdivision (c)(3)b. — A secured party complies with the requirement for notification prescribed by sub-subdivision (c)(3)b. of this section if:

(1) Not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in sub-subdivision (c)(3)b. of this section; and

(2) Before the notification date, the secured party:

a. Did not receive a response to the request for information; or

b. Received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-504(3).

2. **Reasonable Notification.** This section requires a secured party who wishes to dispose of collateral under section 9-610 to send "a reasonable authenticated notification of disposition" to specified interested persons, subject to certain exceptions. The notification must be reasonable as to the manner in which it is sent, its timeliness (i.e., a reasonable time before the disposition is to take place), and its content. See sections 9-612 (timeliness of notification), 9-613 (contents of notification generally), 9-614 (contents of notification in consumer-goods transactions).

3. **Notification to Debtors and Secondary Obligors.** This section imposes a duty to send notification of a disposition not only to the debtor but also to any secondary obligor. Subsections (b) and (c) resolve an uncertainty under former article 9 by providing that secondary obligors (sureties) are entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be a secondary obligor. (This article also resolves the question of the secondary obligor's ability to waive, pre-default, the right to notification—waiver generally is not permitted. See section 9-602.) Section 9-605 relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

Under subsection (b), the principal obligor (borrower) is not always entitled to notification of disposition.

Example: Behnfeldt borrows on an unsecured basis, and Bruno grants a security interest in her car to secure the debt. Behnfeldt is a primary obligor, not a secondary obligor. As such, she is not entitled to notification of disposition under this section.

4. **Notification to Other Secured Parties.** Prior to the 1972 amendments to article 9, former section 9-504(3) required the enforcing secured party to send reasonable notification of the disposition:

except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral.

The 1972 amendments eliminated the duty to give notice to secured parties other than those from whom the foreclosing secured party had received written notice of a claim of an interest in the collateral.

Many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. To this end, subsection (c)(3)(B) expands the duties of the foreclosing secured party to include the duty to notify (and the corresponding burden of searching the files to discover) certain competing secured parties. The subsection imposes a search burden that in some cases may be greater than the pre-1972 burden on foreclosing secured parties but certainly is more modest than that faced by a new secured lender.

To determine who is entitled to notification, the foreclosing secured party must determine the proper office for filing a financing statement as of a particular date, measured by reference to the "notification date," as defined in subsection (a). This determination requires reference to the choice of law provisions of part 3. The secured party must ascertain whether any financing statements covering the collateral and indexed under the debtor's name, as the name existed as of that date, in fact were filed in that office. The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor's name.

Under subsection (c)(3)(C), the secured party also must notify a secured party who has perfected a security interest by complying with a statute or treaty described in section 9-311(a), such as a certificate of title statute.

Subsection (e) provides a "safe harbor" that takes into account the delays that may be attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duty under subsection (c)(3)(B) if it requests a search from the proper office at least 20 but not more than 30 days before sending notification to the debtor and if it also sends a notification to all secured parties (and other lienholders) reflected on the search report. The secured party's duty under subsection (c)(3)(B) also will be satisfied if the secured party requests but does not receive a search report before the notification is sent to the debtor. Thus, if subsection (e) applies, a secured party who is entitled to notification under subsection (c)(3)(B) has no remedy against a foreclosing secured party who does not send the notification. The foreclosing secured party has complied with the notification requirement. Subsection (e) has no effect on the requirements of the other paragraphs of subsection (c). For example, if the foreclosing secured party received a notification from the holder of a conflicting security interest in accordance with subsection (c)(3)(A) but failed to send to the holder a notification of the disposition, the holder of the conflicting security interest would have the right to recover any loss under section 9-625(b).

5. **Authentication Requirement.** Subsections (b) and (c) explicitly provide that a notification of disposition must be "authenticated." Some cases read former section 9-504(3) as validating oral notification.

6. **Second Try.** This article leaves to judicial resolution, based upon the facts of each case, the question whether the requirement of "reasonable notification" requires a "second try," i.e., whether a secured party who sends notification and learns that the debtor did not receive it must attempt to locate the debtor and send another notification.

7. **Recognized Market; Perishable Collateral.** New subsection (d) makes it clear that there is no obligation to give notification of a disposition in the case of perishable collateral or collateral customarily sold on a recognized market (e.g., marketable securities). Former section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to notify a debtor but not from its duty to notify other secured parties in connection with dispositions of such collateral.

8. **Failure to Conduct Notified Disposition.** Nothing in this article prevents a secured party from electing not to conduct a disposition after sending a notification. Nor does this article prevent a secured party from electing to send a revised notification if its plans for disposition change. This assumes, however, that the secured party acts in good faith, the revised notification is reasonable, and the revised plan for disposition and any attendant delay are commercially reasonable.

9. **Waiver.** A debtor or secondary obligor may waive the right to notification under this section only by a post-default authenticated agreement. See section 9-624(a).

CASE NOTES

***Editor's Note.** — The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Notice to Debtor Required. — Where, prior to the filing by debtor of a voluntary petition in bankruptcy, creditor with a nonpossessory, nonpurchase money security interest in debtor's household goods repossessed and sold the collateral at private sale, the creditor was required under former G.S. 25-9-504(3) to send written notice to the debtor, and failure to do so made creditor liable to debtor under former G.S. 25-9-507. Wood v. Provident Fin. Co., 13 Bankr. 245 (Bankr. E.D.N.C. 1981).

Notice of Collection. — The court found that notice was required under former G.S. 25-9-507 to debtors who provided instruments as collateral before the secured party collected under those instruments upon default. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996), cert. granted, 345 N.C. 346, 483 S.E.2d 176 (1997).

Burden of Proving Notice to Debtor. — In actions by a creditor to obtain a deficiency judgment, the burden of proving that notice was properly sent by the creditor to the debtor rests with the creditor. North Carolina Nat'l Bank v. Burnette, 38 N.C. App. 120, 247 S.E.2d 648 (1978), rev'd on other grounds, 297 N.C. 524, 256 S.E.2d 388 (1979).

Effort to Notify Held Reasonable. — Creditor's effort to notify debtors of private sale by sending a first class letter to debtors' last known address was reasonable where there was no evidence that the letter was returned, or that the debtors did not receive such notice, or that the debtors had provided creditor with a new address. In re Marshall, 219 Bankr. 687 (Bankr. M.D.N.C. 1997).

Effect of Failure to Give Notice of Sale. — Lack of notice raises a presumption that the collateral was worth at least the amount of the debt. This is not a conclusive presumption, however, and may be overcome by the creditor by proving that the collateral was sold at market value, and that the market value was less than the amount of the debt. Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

A creditor's failure to give the debtor notice of the sale of collateral does not bar the creditor from obtaining a deficiency judgment against the debtor, provided that the creditor can prove that the sale resulted in the collateral's bringing its market value. Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

A creditor's failure to give the required notice does not absolutely bar a deficiency judgment. Rather, the debt will be credited with the amount that reasonably could have been obtained via a commercially reasonable sale of the collateral. Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

§ 25-9-612. Timeliness of notification before disposition of collateral.

(a) Reasonable time is question of fact. — Except as otherwise provided in subsection (b) of this section, whether a notification is sent within a reasonable time is a question of fact.

(b) Ten-day period sufficient in nonconsumer transaction. — In a transaction other than a consumer transaction, a notification of disposition sent after default and 10 days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Reasonable Notification.** Section 9-611(b) requires the secured party to send a "reasonable authenticated notification." Under that section, as under former section 9-504(3), one aspect of a reasonable notification is its timeliness. This generally means that the notification must be sent at a reasonable time in advance of the date of a public disposition or the date after which a private disposition is to be made. A notification that is sent so near to the disposition date that a notified person could not be expected to act on or take account of the notification would be unreasonable.

3. **Timeliness of Notification: Safe Harbor.** The 10-day notice period in subsection (b) is intended to be a "safe harbor" and not a minimum requirement. To qualify for the "safe harbor" the notification must be sent after default. A notification also must be sent in a commercially reasonable manner. See section 9-611(b) ("reasonable authenticated notification"). These requirements prevent a secured party from taking advantage of the "safe har-

bor" by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas.

§ 25-9-613. Contents and form of notification before disposition of collateral: general.

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:
  a. Describes the debtor and the secured party;
  b. Describes the collateral that is the subject of the intended disposition;
  c. States the method of intended disposition;
  d. States that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and
  e. States the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in subdivision (1) of this section are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in subdivision (1) of this section are sufficient, even if the notification includes:
  a. Information not specified by that subdivision; or
  b. Minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in G.S. 25-9-614(3), when completed, each provides sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: [Name of debtor, obligor, or other person to which the notification is sent]
From: [Name, address, and telephone number of secured party]
Name of Debtor(s): [Include only if debtor(s) is/are not an addressee]
[For a public disposition:]
We will sell [or lease or license, as applicable] the [describe collateral] [to the highest qualified bidder] in public as follows:
Day and Date: ______________________
Time: ______________________
Place: ______________________
[For a private disposition:]
We will sell [or lease or license, as applicable] the [describe collateral] privately sometime after [day and date] .
You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, as applicable] [for a charge of $ ________].
You may request an accounting by calling us at [telephone number]
(2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Contents of Notification.** To comply with the "reasonable authenticated notification" requirement of section 9-611(b), the contents of a notification must be reasonable. Except in a consumer-goods transaction, the contents of a notification that includes the information set forth in paragraph (1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to "time" of disposition means here, as

it did in former section 9-504(3), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be reasonable by the trier of fact, under paragraph (2). A properly completed sample form of notification in paragraph (5) or in section 9-614(3) is an example of a notification that would contain the information set forth in paragraph (1). Under paragraph (4), however, no particular phrasing of the notification is required.

§ 25-9-614. Contents and form of notification before disposition of collateral: consumer-goods transaction.

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:
  a. The information specified in G.S. 25-9-613(1);
  b. A description of any liability for a deficiency of the person to which the notification is sent;
  c. A telephone number from which the amount that must be paid to the secured party to redeem the collateral under G.S. 25-9-623 is available; and
  d. A telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

[Name and address of secured party]
[Date]

NOTICE OF OUR PLAN TO SELL PROPERTY

[Name and address of any obligor who is also a debtor]

Subject: [Identification of Transaction]

We have your [describe collateral] , because you broke promises in our agreement.

[For a public disposition:]
We will sell [describe collateral] at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: ______________________
Time: ______________________
Place: ______________________
You may attend the sale and bring bidders if you want.

[For a private disposition:]
We will sell [describe collateral] at private sale sometime after [date] . A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you [will or will not, as applicable] still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at [telephone number] .

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at [telephone number] or write us at [secured party's address] and request a written explanation. [We will charge you $ ________ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at [telephone number] [or write us at [secured party's address] .

We are sending this notice to the following other people who have an interest in [describe collateral] or who owe money under your agreement:
[Names of all other debtors and obligors, if any]

(4) A notification in the form of subdivision (3) of this section is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of subdivision (3) of this section is sufficient, even if it includes errors in information not required by subdivision (1) of this section, unless the error is misleading with respect to rights arising under this Article.

(6) If a notification under this section is not in the form of subdivision (3) of this section, law other than this Article determines the effect of including information not required by subdivision (1) of this section. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Notification in Consumer-Goods Transactions.** Paragraph (1) sets forth the information required for a reasonable notification in a consumer-goods transaction. A notification that lacks any of the information set forth in paragraph (1) is insufficient as a matter of law. Compare section 9-613(2), under which the trier of fact may find a notification to be sufficient even if it lacks some information listed in paragraph (1) of that section.

3. **Safe-Harbor Form of Notification; Errors in Information.** Although paragraph (2) provides that a particular phrasing of a notification is not required, paragraph (3) specifies a safe-harbor form that, when properly completed, satisfies paragraph (1). Paragraphs (4), (5), and (6) contain special rules applicable to erroneous and additional information. Under paragraph (4), a notification in the safe-harbor form specified in paragraph (3) is not rendered insufficient if it contains additional information at the end of the form. Paragraph (5) provides that nonmisleading errors in information contained in a notification are permitted if the safe-harbor form is used and if the errors are in information not required by paragraph (1). Finally, if a notification is in a form other than the paragraph (3) safe-harbor form, other law determines the effect of including in the notification information other than that required by paragraph (1).

CASE NOTES

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-615. Application of proceeds of disposition; liability for deficiency and right to surplus.

(a) Application of proceeds. — A secured party shall apply or pay over for application the cash proceeds of disposition under G.S. 25-9-610 in the following order to:

(1) The reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) The satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) The satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

a. The secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

b. In a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(4) A secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) Proof of subordinate interest. — If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subdivision (a)(3) of this section.

(c) Application of noncash proceeds. — A secured party need not apply or pay over for application noncash proceeds of disposition under G.S. 25-9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) Surplus or deficiency if obligation secured. — If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) of this section and permitted by subsection (c) of this section:

(1) Unless subdivision (a)(4) of this section requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) The obligor is liable for any deficiency.

(e) No surplus or deficiency in sales of certain rights to payment. — If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(1) The debtor is not entitled to any surplus; and

(2) The obligor is not liable for any deficiency.

(f) Calculation of surplus or deficiency in disposition to person related to secured party. — The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this Part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(1) The transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(2) The amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) Cash proceeds received by junior secured party. — A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) Takes the cash proceeds free of the security interest or other lien;

(2) Is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) Is not obligated to account to or pay the holder of the security interest or other lien for any surplus. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-504(1) and (2).

2. **Application of Proceeds.** This section contains the rules governing application of proceeds and the debtor's liability for a deficiency following a disposition of collateral. Subsection (a) sets forth the basic order of application. The proceeds are applied first to the expenses of disposition, second to the obligation secured by the security interest that is being enforced, and third, in the specified circumstances, to interests that are subordinate to that security interest.

Subsections (a) and (d) also address the right of a consignor to receive proceeds of a disposition by a secured party whose interest is senior to that of the consignor. Subsection (a) requires the enforcing secured party to pay excess proceeds first to subordinate secured parties or lienholders whose interests are senior to that of a consignor and, finally, to a consignor. Inasmuch as a consignor is the owner of the collateral, secured parties and lienholders whose interests are junior to the consignor's interest will not be entitled to any proceeds. In like fashion, under subsection (d)(1) the debtor is not entitled to a surplus when the enforcing secured party is required to pay over proceeds to a consignor.

3. **Noncash Proceeds.** Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in section 9-608, comment 4, generally applies to this subsection.

Example: A secured party in the business of selling or financing automobiles takes possession of collateral (an automobile) following its debtor's default. The secured party decides to sell the automobile in a private disposition under section 9-610 and sends appropriate notification under section 9-611. After undertaking its normal credit investigation and in accordance with its normal credit policies, the secured party sells the automobile on credit, on terms typical of the credit terms normally extended by the secured party in the ordinary course of its business. The automobile stands as collateral for the remaining balance of the price. The noncash proceeds received by the secured party are chattel paper. The secured party may wish to credit its debtor (the assignor) with the principal amount of the chattel paper or may wish to credit the debtor only as and when the payments are made on the chattel paper by the buyer.

Under subsection (c), the secured party is under no duty to apply the noncash proceeds (here, the chattel paper) or their value to the secured obligation unless its failure to do so would be commercially unreasonable. If a secured party elects to apply the chattel paper to the outstanding obligation, however, it must do so in a commercially reasonable manner. The facts in the example indicate that it would be commercially unreasonable for the secured party to fail to apply the value of the chattel paper to the original debtor's secured obligation. Unlike the example in comment 4 to section 9-608, the noncash proceeds received in this example are of the type that the secured party regularly generates in the ordinary course of its financing business in nonforeclosure transactions. The original debtor should not be exposed to delay or uncertainty in this situation. Of course, there will be many situations that fall between the examples presented in the comment to section 9-608 and in this comment. This article leaves their resolution to the court based on the facts of each case.

One would expect that where noncash proceeds are or may be material, the secured party and debtor would agree to more specific standards in an agreement entered into before or after default. The parties may agree to the method of application of noncash proceeds if the method is not manifestly unreasonable. See section 9-603.

When the secured party is not required to "apply or pay over for application noncash proceeds," the proceeds nonetheless remain collateral subject to this article. See section 9-608, comment 4.

4. **Surplus and Deficiency.** Subsection (d) deals with surplus and deficiency. It revises former section 9-504(2) by imposing an explicit requirement that the secured party "pay" the debtor for any surplus, while retaining the secured party's duty to "account." Inasmuch as the debtor may not be an obligor, subsection (d) provides that the obligor (not the debtor) is liable for the deficiency. The special rule governing surplus and deficiency when receivables have been sold likewise takes into account the distinction between a debtor and an obligor. Subsection (d) also addresses the situation in which a consignor has an interest that is subordinate to the security interest being enforced.

5. **Collateral Under New Ownership.** When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest

in the collateral; the buyer is the debtor. See section 9-102. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus following a disposition. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But, because this situation typically arises as a result of the debtor's wrongful act, this article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the buyer and accordingly pays the surplus to the original debtor, the exculpatory provisions of this article exonerate the secured party from liability to the buyer. See sections 9-605 and 9-628(a) and (b). If a debtor sells collateral free of a security interest, as in a sale to a buyer in ordinary course of business (see section 9-320(a)), the property is no longer collateral and the buyer is not a debtor.

6. **Certain "Low-Price" Dispositions.** Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, a person related to the secured party (defined in section 9-102), or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this article (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price.

Subsection (f) adjusts for this lack of incentive. If the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought," then instead of calculating a deficiency (or surplus) based on the actual net proceeds, the calculation is based upon the amount that would have been received in a commercially reasonable disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor. Subsection (f) thus rejects the view that the secured party's receipt of such a price necessarily constitutes noncompliance with part 6. However, such a price may suggest the need for greater judicial scrutiny. See section 9-610, comment 10.

7. **"Person Related To."** Section 9-102 defines "person related to." That term is a key element of the system provided in subsection (f) for low-price dispositions. One part of the definition applies when the secured party is an individual, and the other applies when the secured party is an organization. The definition is patterned closely on the corresponding definition in section 1.301(32) of the Uniform Consumer Credit Code.

CASE NOTES

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

Partial summary judgment. — When a trial court entered partial summary judgment in favor of an auctioneer suing for its fees from a sale of repossessed collateral, that judgment implicitly found the sale was commercially reasonable under G.S. 25-9-610(b) and G.S. 25-9-615(a)(1), so the judgment was immediately appealable because remaining claims before the trial court also required a determination of commercial reasonableness, creating a risk of inconsistent judgments which could prejudice a guarantor the auctioneer was suing, and that judgment affected a substantial right. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

Commercial Reasonableness. — When a creditor which had contracted with an auctioneer to sell a defaulting debtor's collateral transferred its rights to another, which entered into a second contract with the auctioneer, the fact that the second contract was less favorable than the first to a guarantor's rights against the debtor did not render its terms commercially unreasonable, under G.S. 25-9-109, G.S. 25-9-615(a)(1), or G.S. 25-9-610(b), because there was sufficient evidence that a presumptively reasonable public sale was held, and the guarantor did not have standing as an intended third-party beneficiary of the first contract to enforce it. Country Boys Auction & Realty Co. v. Carolina Warehouse, Inc., — N.C. App. —, 636 S.E.2d 309, 2006 N.C. App. LEXIS 2243 (2006).

§ 25-9-616. Explanation of calculation of surplus or deficiency.

(a) Definitions. — In this section:

(1) "Explanation" means a writing that:

a. States the amount of the surplus or deficiency;

b. Provides an explanation in accordance with subsection (c) of this section of how the secured party calculated the surplus or deficiency;

c. States, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates, and expenses may affect the amount of the surplus or deficiency; and

d. Provides a telephone number or mailing address from which additional information concerning the transaction is available.

(2) "Request" means a record:

a. Authenticated by a debtor or consumer obligor;

b. Requesting that the recipient provide an explanation; and

c. Sent after disposition of the collateral under G.S. 25-9-610.

(b) Explanation of calculation. — In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under G.S. 25-9-615, the secured party shall:

(1) Send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:

a. Before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and

b. Within 14 days after receipt of a request; or

(2) In the case of a consumer obligor who is liable for a deficiency, within 14 days after receipt of a request, send to the consumer obligor a record waiving the secured party's right to a deficiency.

(c) Required information. — To comply with sub-subdivision (a)(1)b. of this section, a writing must provide the following information in the following order:

(1) The aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

a. If the secured party takes or receives possession of the collateral after default, not more than 35 days before the secured party takes or receives possession; or

b. If the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than 35 days before the disposition;

(2) The amount of proceeds of the disposition;

(3) The aggregate amount of the obligations after deducting the amount of proceeds;

(4) The amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney's fees secured by the collateral which are known to the secured party and relate to the current disposition;

(5) The amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in subdivision (1) of this subsection; and

(6) The amount of the surplus or deficiency.

(d) Substantial compliance. — A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (a) of this section is sufficient, even if it includes minor errors that are not seriously misleading.

(e) Charges for responses. — A debtor or consumer obligor is entitled without charge to one response to a request under this section during any six-month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to subdivision (b)(1) of this section. The secured party may require payment of a charge not exceeding twenty-five dollars ($25.00) for each additional response. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Duty to Send Information Concerning Surplus or Deficiency.** This section reflects the view that, in every consumer-goods transaction, the debtor or obligor is entitled to know the amount of a surplus or deficiency and the basis upon which the surplus or deficiency was calculated. Under subsection (b)(1), a secured party is obligated to provide this information (an "explanation," defined in subsection (a)(1)) no later than the time that it accounts for and pays a surplus or the time of its first written attempt to collect the deficiency. The obligor need not make a request for an accounting in order to receive an explanation. A secured party who does not attempt to collect a deficiency in writing or account for and pay a surplus has no obligation to send an explanation under subsection (b)(1) and, consequently, cannot be liable for noncompliance.

A debtor or secondary obligor need not wait until the secured party commences written collection efforts in order to receive an explanation of how a deficiency or surplus was calculated. Subsection (b)(2) obliges the secured party to send an explanation within 14 days after it receives a "request" (defined in subsection (a)(2)).

3. **Explanation of Calculation of Surplus or Deficiency.** Subsection (c) contains the requirements for how a calculation of a surplus or deficiency must be explained in order to satisfy subsection (a)(1)(B). It gives a secured party some discretion concerning rebates of interest or credit service charges. The secured party may include these rebates in the aggregate amount of obligations secured, under subsection (c)(1), or may include them with other types of rebates and credits under subsection (c)(5). Rebates of interest or credit service charges are the only types of rebates for which this discretion is provided. If the secured party provides an explanation that includes rebates of precomputed interest, its explanation must so indicate. The expenses and attorney's fees to be described pursuant to subsection (c)(4) are those relating to the most recent disposition, not those that may have been incurred in connection with earlier enforcement efforts and which have been resolved by the parties.

4. **Liability for Noncompliance.** A secured party who fails to comply with subsection (b)(2) is liable for any loss caused plus $500. See section 9-625(b), (c), and (e)(6). A secured party who fails to send an explanation under subsection (b)(1) is liable for any loss caused plus, if the noncompliance was "part of a pattern, or consistent with a practice of noncompliance," $500. See section 9-625(b), (c), and (e)(5). However, a secured party who fails to comply with this section is not liable for statutory minimum damages under section 9-625(c)(2). See section 9-628(d).

§ 25-9-617. Rights of transferee of collateral.

(a) Effects of disposition. — A secured party's disposition of collateral after default:

(1) Transfers to a transferee for value all of the debtor's rights in the collateral;

(2) Discharges the security interest under which the disposition is made; and

(3) Discharges any subordinate security interest or other subordinate lien.

(b) Rights of good-faith transferee. — A transferee that acts in good faith takes free of the rights and interests described in subsection (a) of this section, even if the secured party fails to comply with this Article or the requirements of any judicial proceeding.

(c) Rights of other transferee. — If a transferee does not take free of the rights and interests described in subsection (a) of this section, the transferee takes the collateral subject to:

(1) The debtor's rights in the collateral;

(2) The security interest or agricultural lien under which the disposition is made; and

(3) Any other security interest or other lien. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-504(4).

2. **Title Taken by Good Faith Transferee.** Subsection (a) sets forth the rights acquired by persons who qualify under subsection (b)—transferees who act in good faith. Such a person is a "transferee," inasmuch as a buyer at a foreclosure sale does not meet the definition of "purchaser" in section 1-201 (the transfer is not, vis-a-vis the debtor, "voluntary"). By virtue of the expanded definition of the term "debtor" in section 9-102, subsection (a) makes clear that the ownership interest of a person who bought the collateral subject to the security interest is terminated by a subsequent disposition under this part. Such a person is a debtor under this article. Under former article 9, the result arguably was the same, but the statute was less clear. Under subsection (a), a disposition normally discharges the security interest being foreclosed and any subordinate security interests and other liens.

A disposition has the effect specified in subsection (a), even if the secured party fails to comply with this article. An aggrieved person (e.g., the holder of a subordinate security interest to whom a notification required by section 9-611 was not sent) has a right to recover any loss under section 9-625(b).

3. **Unitary Standard in Public and Private Dispositions.** Subsection (b) now contains a unitary standard that applies to transferees in both private and public dispositions—acting in good faith. However, this change from former section 9-504(4) should not be interpreted to mean that a transferee acts in good faith even though it has knowledge of defects or buys in collusion, standards applicable to public dispositions under the former section. Properly understood, those standards were specific examples of the absence of good faith.

4. **Title Taken by Nonqualifying Transferee.** Subsection (c) specifies the consequences for a transferee who does not qualify for protection under subsections (a) and (b) (i.e., a transferee who does not act in good faith). The transferee takes subject to the rights of the debtor, the enforcing secured party, and other security interests or other liens.

§ 25-9-618. Rights and duties of certain secondary obligors.

(a) Rights and duties of secondary obligor. — A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

(1) Receives an assignment of a secured obligation from the secured party;

(2) Receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or

(3) Is subrogated to the rights of a secured party with respect to collateral.

(b) Effect of assignment, transfer, or subrogation. — An assignment, transfer, or subrogation described in subsection (a) of this section:

(1) Is not a disposition of collateral under G.S. 25-9-610; and

(2) Relieves the secured party of further duties under this Article. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-504(5).

2. **Scope of This Section.** Under this section, assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which part 6 applies. Rather, they constitute assignments of rights and (occasionally) delegations of duties.

Application of this section may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to "purchase the collateral" but contemplates that the purchaser will then conduct an article 9 foreclosure disposition).

This section, like former section 9-504(5), does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in situations involving a secondary obligor described in subsection (a). In other contexts, the agreement of the parties and applicable law other than article 9 determine whether the assignment imposes upon the assignee any duty to the debtor and whether the assignor retains its duties to the debtor after the assignment.

Subsection (a)(1) applies when there has been an assignment of an obligation that is secured at the time it is assigned. Thus, if a secondary obligor acquires the collateral at a disposition under section 9-610 and simultaneously or subsequently discharges the unsecured deficiency claim, subsection (a)(1) is not implicated. Similarly, subsection (a)(3) applies only when the secondary obligor is subrogated to the secured party's rights with respect to collateral. Thus, this subsection will not be implicated if a secondary obligor discharges the debtor's unsecured obligation for a post-disposition deficiency. Similarly, if the secured party disposes of some of the collateral and the secondary obligor thereafter discharges the remaining obligation, subsection (a) applies only with respect to rights and duties concerning the remaining collateral, and, under subsection (b), the subrogation is not a disposition of the remaining collateral.

As discussed more fully in comment 3, a secondary obligor may receive a transfer of collateral in a disposition under section 9-610 in exchange for a payment that is applied against the secured obligation. However, a secondary obligor who pays and receives a transfer of collateral does not necessarily become subrogated to the rights of the secured party as contemplated by subsection (a)(3). Only to the extent the secondary obligor makes a payment in satisfaction of its secondary obligation would it become subrogated. To the extent its payment constitutes the price of the collateral in a section 9-610 disposition by the secured party, the secondary obligor would not be subrogated. Thus, if the amount paid by the secondary obligor for the collateral in a section 9-610 disposition is itself insufficient to discharge the secured obligation, but the secondary obligor makes an additional payment that satisfies the remaining balance, the secondary obligor would be subrogated to the secured party's deficiency claim. However, the duties of the secured party as such would have come to an end with respect to that collateral. In some situations the capacity in which the payment is made may be unclear. Accordingly, the parties should in their relationship provide clear evidence of the nature and circumstances of the payment by the secondary obligor.

3. **Transfer of Collateral to Secondary Obligor.** It is possible for a secured party to transfer collateral to a secondary obligor in a transaction that is a disposition under section 9-610 and that establishes a surplus or deficiency under section 9-615. Indeed, this article includes a special rule, in section 9-615(f), for establishing a deficiency in the case of some dispositions to, inter alia, secondary obligors. This article rejects the view, which some may have ascribed to former section 9-504(5), that a transfer of collateral to a recourse party can never constitute a disposition of collateral which discharges a security interest. Inasmuch as a secured party could itself buy collateral at its own public sale, it makes no sense to prohibit a recourse party ever from buying at the sale.

4. **Timing and Scope of Obligations.** Under subsection (a), a recourse party acquires rights and incurs obligations only "after" one of the specified circumstances occurs. This makes clear that when a successor assignee, transferee, or subrogee becomes obligated it does not assume any liability for earlier actions or inactions of the secured party whom it has succeeded unless it agrees to do so. Once the successor becomes obligated, however, it is responsible for complying with the secured party's duties thereafter. For example, if the successor is in possession of collateral, then it has the duties specified in section 9-207.

Under subsection (b), the same event (assignment, transfer, or subrogation) that gives rise to rights to, and imposes obligations on, a successor relieves its predecessor of any further duties under this article. For example, if the security interest is enforced after the secured obligation is assigned, the assignee—but not the assignor—has the duty to comply with this part. Similarly, the assignment does not excuse the assignor from liability for failure to comply with duties that arose before the event or impose liability on the assignee for the assignor's failure to comply.

§ 25-9-619. Transfer of record or legal title.

(a) "Transfer statement." — In this section, "transfer statement" means a record authenticated by a secured party stating:

(1) That the debtor has defaulted in connection with an obligation secured by specified collateral;

(2) That the secured party has exercised its postdefault remedies with respect to the collateral;

(3) That, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and

(4) The name and mailing address of the secured party, debtor, and transferee.

(b) Effect of transfer statement. — A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:

(1) Accept the transfer statement;

(2) Promptly amend its records to reflect the transfer; and

(3) If applicable, issue a new appropriate certificate of title in the name of the transferee.

(c) Transfer not a disposition; no relief of secured party's duties. — A transfer of the record or legal title to collateral to a secured party under subsection (b) of this section or otherwise is not of itself a disposition of collateral under this Article and does not of itself relieve the secured party of its duties under this Article. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Transfer of Record or Legal Title.** Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If the record owner is the debtor and, as may be the case after the default, the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral.

Subsection (b) provides a simple mechanism for obtaining record or legal title, for use primarily when other law does not provide one. Of course, use of this mechanism will not be effective to clear title to the extent that subsection (b) is preempted by federal law. Subsection (b) contemplates a transfer of record or legal title to a third party, following a secured party's exercise of its disposition or acceptance remedies under this part, as well as a transfer by a debtor to a secured party prior to the secured party's exercise of those remedies. Under subsection (c), a transfer of record or legal title (under subsection (b) or under other law) to a secured party prior to the exercise of those remedies merely puts the secured party in a position to pass legal or record title to a transferee at foreclosure. A secured party who has obtained record or legal title retains its duties with respect to enforcement of its security interest, and the debtor retains its rights as well.

3. **Title-Clearing Systems Under Other Law.** Applicable non-UCC law (e.g., a certificate of title statute, federal registry rules, or the like) may provide a means by which the secured party may obtain or transfer record or legal title for the purpose of a disposition of the property under this article. The mechanism provided by this section is in addition to any title clearing provision under law other than this article.

CASE NOTES

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-620. Acceptance of collateral in full or partial satisfaction of obligation; compulsory disposition of collateral.

(a) Conditions to acceptance in satisfaction. — Except as otherwise provided in subsection (g) of this section, a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) The debtor consents to the acceptance under subsection (c) of this section;

(2) The secured party does not receive, within the time set forth in subsection (d) of this section, a notification of objection to the proposal authenticated by:

a. A person to which the secured party was required to send a proposal under G.S. 25-9-621; or

b. Any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal;

(3) If the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance; and

(4) Subsection (e) of this section does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to G.S. 25-9-624.

(b) Purported acceptance ineffective. — A purported or apparent acceptance of collateral under this section is ineffective unless:

(1) The secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and

(2) The conditions of subsection (a) of this section are met.

(c) Debtor's consent. — For purposes of this section:

(1) A debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) A debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

a. Sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

b. In the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

c. Does not receive a notification of objection authenticated by the debtor within 20 days after the proposal is sent.

(d) Effectiveness of notification. — To be effective under subdivision (a)(2) of this section, a notification of objection must be received by the secured party:

(1) In the case of a person to which the proposal was sent pursuant to G.S. 25-9-621, within 20 days after notification was sent to that person; and

(2) In other cases:

a. Within 20 days after the last notification was sent pursuant to G.S. 25-9-621; or

b. If a notification was not sent, before the debtor consents to the acceptance under subsection (c) of this section.

(e) Mandatory disposition of consumer goods. — A secured party that has taken possession of collateral shall dispose of the collateral pursuant to G.S. 25-9-610 within the time specified in subsection (f) of this section if:

(1) Sixty percent (60%) of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) Sixty percent (60%) of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

(f) Compliance with mandatory disposition requirement. — To comply with subsection (e) of this section, the secured party shall dispose of the collateral:

(1) Within 90 days after taking possession; or

(2) Within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(g) No partial satisfaction in consumer transaction. — In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-505.

2. **Overview.** This section and the two sections following deal with strict foreclosure, a procedure by which the secured party acquires the debtor's interest in the collateral without the need for a sale or other disposition under section 9-610. Although these provisions derive from former section 9-505, they have been entirely reorganized and substantially rewritten. The more straightforward approach taken in this article eliminates the fiction that the secured party always will present a "proposal" for the retention of collateral and the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in that fashion, this section eliminates much of the awkwardness of former section 9-505. It reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned.

Subsection (a) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. Section 9-621 requires in addition that a secured party who wishes to proceed under this section notify certain other persons who have or claim to have an interest in the collateral. Unlike the failure to meet the conditions in subsection (a), under section 9-622(b) the failure to comply with the notification requirement of section 9-621 does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party's noncompliance. A person to whom the required notice was not sent has the right to recover damages under section 9-625(b). Section 9-622(a) sets forth the effect of an acceptance of collateral.

3. **Conditions to Effective Acceptance.** Subsection (a) contains the conditions necessary to the effectiveness of an acceptance of collateral. Subsection (a)(1) requires the debtor's consent. Under subsections (c)(1) and (c)(2), the debtor may consent by agreeing to the acceptance in writing after default. Subsection (c)(2) contains an alternative method by which to satisfy the debtor's-consent condition in subsection (a)(1). It follows the proposal-and-objection model found in former section 9-505: The debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 20 days. Under subsection (c)(1), however, that silence is not deemed to be consent with respect to acceptances in partial satisfaction. Thus, a secured party who wishes to conduct a "partial strict foreclosure" must obtain the debtor's agreement in a record authenticated after default. In all other respects, the conditions necessary to an effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction. (But see subsection (g), prohibiting partial strict foreclosure of a security interest in consumer transactions.)

The time when a debtor consents to a strict foreclosure is significant in several circumstances under this section and the following one. See sections 9-620(a)(1), (d)(2), 9-621(a)(1), (a)(2), and (a)(3). For purposes of determining the time of consent, a debtor's conditional consent constitutes consent.

Subsection (a)(2) contains the second condition to the effectiveness of an acceptance under this section—the absence of a timely objection from a person holding a junior interest in the collateral or from a secondary obligor. Any junior party—secured party or lienholder—is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under section 9-621. Subsection (d), discussed below, indicates when an objection is timely.

Subsections (a)(3) and (a)(4) contain special rules for transactions in which consumers are involved. See comment 12.

4. **Proposals.** Section 9-102 defines the term

"proposal." It is necessary to send a "proposal" to the debtor only if the debtor does not agree to an acceptance in an authenticated record as described in subsection (c)(1) or (c)(2). Section 9-621(a) determines whether it is necessary to send a proposal to third parties. A proposal need not take any particular form as long as it sets forth the terms under which the secured party is willing to accept collateral in satisfaction. A proposal to accept collateral should specify the amount (or a means of calculating the amount, such as by including a per diem accrual figure) of the secured obligations to be satisfied, state the conditions (if any) under which the proposal may be revoked, and describe any other applicable conditions. Note, however, that a conditional proposal generally requires the debtor's agreement in order to take effect. See subsection (c).

5. **Secured Party's Agreement; No "Constructive" Strict Foreclosure.** The conditions of subsection (a) relate to actual or implied consent by the debtor and any secondary obligor or holder of a junior security interest or lien. To ensure that the debtor cannot unilaterally cause an acceptance of collateral, subsection (b) provides that compliance with these conditions is necessary but not sufficient to cause an acceptance of collateral. Rather, under subsection (b), acceptance does not occur unless, in addition, the secured party consents to the acceptance in an authenticated record or sends to the debtor a proposal. For this reason, a mere delay in collection or disposition of collateral does not constitute a "constructive" strict foreclosure. Instead, delay is a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of section 9-607 or 9-610. A debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral does not, of itself, necessarily raise an implication that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section.

6. **When Acceptance Occurs.** This section does not impose any formalities or identify any steps that a secured party must take in order to accept collateral once the conditions of subsections (a) and (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met provides a sufficient indication that the secured party has accepted the collateral on the terms to which the secured party has consented or proposed and the debtor has consented or failed to object. Following a proposal, acceptance of the collateral normally is automatic upon the secured party's becoming bound and the time for objection passing. As a matter of good business practice, an enforcing secured party may wish to memorialize its acceptance following a proposal, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The secured party's agreement to accept collateral is self-executing and cannot be breached. The secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents.

7. **No Possession Requirement.** This section eliminates the requirement in former section 9-505 that the secured party be "in possession" of collateral. It clarifies that intangible collateral, which cannot be possessed, may be subject to a strict foreclosure under this section. However, under subsection (a)(3), if the collateral is consumer goods, acceptance does not occur unless the debtor is not in possession.

8. **When Objection Timely.** Subsection (d) explains when an objection is timely and thus prevents an acceptance of collateral from taking effect. An objection by a person to which notification was sent under section 9-621 is effective if it is received by the secured party within 20 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties who are not entitled to notification) may object at any time within 20 days after the last notification is sent under section 9-621. If no such notification is sent, third parties must object before the debtor agrees to the acceptance in writing or is deemed to have consented by silence. The former may occur any time after default, and the latter requires a 20-day waiting period. See subsection (c).

9. **Applicability of Other Law.** This section does not purport to regulate all aspects of the transaction by which a secured party may become the owner of collateral previously owned by the debtor. For example, a secured party's acceptance of a motor vehicle in satisfaction of secured obligations may require compliance with the applicable motor vehicle certificate of title law. State legislatures should conform those laws so that they mesh well with this section and section 9-610, and courts should construe those laws and this section harmoniously. A secured party's acceptance of collateral in the possession of the debtor also may implicate statutes dealing with a seller's retention of possession of goods sold.

10. **Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes.** If the collateral is accounts, chattel paper, payment intangibles, or promissory notes, then a secured party's acceptance of the collateral in satisfaction of secured obligations would constitute a sale to the secured party. That sale normally would give rise to a new security interest (the ownership interest) under sections 1-201(37) and 9-109. In the case of accounts and chattel paper, the new security interest would remain perfected by a filing that was effective to perfect the secured party's original security

interest. In the case of payment intangibles or promissory notes, the security interest would be perfected when it attaches. See section 9-309. However, the procedures for acceptance of collateral under this section satisfy all necessary formalities and a new security agreement authenticated by the debtor would not be necessary.

11. **Role of Good Faith.** Section 1-203 imposes an obligation of good faith on a secured party's enforcement under this article. This obligation may not be disclaimed by agreement. See section 1-102. Thus, a proposal and acceptance made under this section in bad faith would not be effective. For example, a secured party's proposal to accept marketable securities worth $1,000 in full satisfaction of indebtedness in the amount of $100, made in the hopes that the debtor might inadvertently fail to object, would be made in bad faith. On the other hand, in the normal case proposals and acceptances should be not second guessed on the basis of the "value" of the collateral involved. Disputes about valuation or even a clear excess of collateral value over the amount of obligations satisfied do not necessarily demonstrate the absence of good faith.

12. **Special Rules in Consumer Cases.** Subsection (e) imposes an obligation on the secured party to dispose of consumer goods under certain circumstances. Subsection (f) explains when a disposition that is required under subsection (e) is timely. An effective acceptance of collateral cannot occur if subsection (e) requires a disposition unless the debtor waives this requirement pursuant to section 9-624(b). Moreover, a secured party who takes possession of collateral and unreasonably delays disposition violates subsection (e), if applicable, and may also violate section 9-610 or other provisions of this part. Subsection (e) eliminates as superfluous the express statutory reference to "conversion" found in former section 9-505. Remedies available under other law, including conversion, remain available under this article in appropriate cases. See sections 1-103 and 1-106.

Subsection (g) prohibits the secured party in consumer transactions from accepting collateral in partial satisfaction of the obligation it secures. If a secured party attempts an acceptance in partial satisfaction in a consumer transaction, the attempted acceptance is void.

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

"Secured party" was not synonymous with "titleholder" and holding title was not a prerequisite to being a secured party within the context of former G.S. 25-9-506. Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Husband as Secured Party Although Title Was in Wife's Name. — Trial court did not commit error by treating husband as converter of motor vehicle even though the repossessed vehicle was titled in his wife's name only; where record revealed that defendant husband negotiated with plaintiff throughout the financial transaction regarding the sale of the vehicle, represented to plaintiff that the vehicle's transmission was in good condition, signed the sales agreement conveying the truck to plaintiff, and completed repossession forms with the Department of Motor Vehicles, husband was a party to sales agreement which created a security interest in the vehicle, and therefore was subject to the provisions of this section pertaining to compulsory disposition of collateral. Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Lender's Liability When Collateral Transferred Under Repurchase Agreement. — A lender who repossessed a car and transferred it to a dealer under a repurchase agreement was not liable for the dealer's failure to sell the car within ninety days of repossession as required by former G.S. 25-9-506(1). Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

Not Applicable to Instrument Intended to Be Cashed in. — Former G.S. 25-9-506(2) did not apply where the collateral involved was an instrument which the secured party intended to cash in. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996), cert. granted, 345 N.C. 346, 483 S.E.2d 176 (1997).

The failure to give notice and/or to dispose of collateral in a commercially reasonable manner results in: (1) a presumption that the collateral was worth at least the amount of the debt; and (2) the amount that could have reasonably been obtained from a commercially reasonable sale of the collateral being credited to the debt. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997), cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-621. Notification of proposal to accept collateral.

(a) Persons to which proposal to be sent. — A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to:

(1) Any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(2) Any other secured party or lienholder that, 10 days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

a. Identified the collateral;

b. Was indexed under the debtor's name as of that date; and

c. Was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) Any other secured party that, 10 days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in G.S. 25-9-311(a).

(b) Proposal to be sent to secondary obligor in partial satisfaction. — A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor in addition to the persons described in subsection (a) of this section. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-505.

2. **Notification Requirement.** Subsection (a) specifies three classes of competing claimants to whom the secured party must send notification of its proposal: (i) Those who notify the secured party that they claim an interest in the collateral; (ii) holders of certain security interests and liens who have filed against the debtor; and (iii) holders of certain security interests who have perfected by compliance with a statute (including a certificate of title statute), regulation, or treaty described in section 9-311(a). With regard to (ii), see section 9-611, comment 4. Subsection (b) also requires notification to any secondary obligor if the proposal is for acceptance in partial satisfaction.

Unlike section 9-611, this section contains no "safe harbor," which excuses an enforcing secured party from notifying certain secured parties and other lienholders. This is because, unlike section 9-610, which requires that a disposition of collateral be commercially reasonable, section 9-620 permits the debtor and secured party to set the amount of credit the debtor will receive for the collateral subject only to the requirement of good faith. An effective acceptance discharges subordinate security interests and other subordinate liens. See section 9-622. If collateral is subject to several liens securing debts much larger than the value of the collateral, the debtor may be disinclined to refrain from consenting to an acceptance by the holder of the senior security interest, even though, had the debtor objected and the senior disposed of the collateral under section 9-610, the collateral may have yielded more than enough to satisfy the senior security interest (but not enough to satisfy all the liens). Accordingly, this section imposes upon the enforcing secured party the risk of the filing office's errors and delay. The holder of a security interest who is entitled to notification under this section but does not receive it has the right to recover under section 9-625(b) any loss resulting from the enforcing secured party's noncompliance with this section.

§ 25-9-622. Effect of acceptance of collateral.

(a) Effect of acceptance. — A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(1) Discharges the obligation to the extent consented to by the debtor;

(2) Transfers to the secured party all of a debtor's rights in the collateral;

(3) Discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and

(4) Terminates any other subordinate interest.

(b) Discharge of subordinate interest notwithstanding noncompliance. — A subordinate interest is discharged or terminated under subsection (a) of this section, even if the secured party fails to comply with this Article. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Effect of Acceptance.** Subsection (a) specifies the effect of an acceptance of collateral in full or partial satisfaction of the secured obligation. The acceptance to which it refers is an effective acceptance. If a purported acceptance is ineffective under section 9-620, e.g., because the secured party receives a timely objection from a person entitled to notification, then neither this subsection nor subsection (b) applies. Paragraph (1) expresses the fundamental consequence of accepting collateral in full or partial satisfaction of the secured obligation—the obligation is discharged to the extent consented to by the debtor. Unless otherwise agreed, the obligor remains liable for any deficiency. Paragraphs (2) through (4) indicate the effects of an acceptance on various property rights and interests. Paragraph (2) follows section 9-617(a) in providing that the secured party acquires "all of a debtor's rights in the collateral." Under paragraph (3), the effect of strict foreclosure on holders of junior security interests and other liens is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured obligation: All junior encumbrances are discharged. Paragraph (4) provides for the termination of other subordinate interests.

Subsection (b) makes clear that subordinate interests are discharged under subsection (a) regardless of whether the secured party complies with this article. Thus, subordinate interests are discharged regardless of whether a proposal was required to be sent or, if required, was sent. However, a secured party's failure to send a proposal or otherwise to comply with this article may subject the secured party to liability under section 9-625.

CASE NOTES

Cited in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-623. Right to redeem collateral.

(a) Persons that may redeem. — A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.

(b) Requirements for redemption. — To redeem collateral, a person shall tender:

(1) Fulfillment of all obligations secured by the collateral; and

(2) The reasonable expenses and attorney's fees described in G.S. 25-9-615(a)(1).

(c) When redemption may occur. — A redemption may occur at any time before a secured party:

(1) Has collected collateral under G.S. 25-9-607;

(2) Has disposed of collateral or entered into a contract for its disposition under G.S. 25-9-610; or

(3) Has accepted collateral in full or partial satisfaction of the obligation it secures under G.S. 25-9-622. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-506.

2. **Redemption Right.** Under this section, as under former section 9-506, the debtor or another secured party may redeem collateral as long as the secured party has not collected (section 9-607), disposed of or contracted for the disposition of (section 9-610), or accepted (section 9-620) the collateral. Although this section generally follows former section 9-506, it extends the right of redemption to holders of nonconsensual liens. To redeem the collateral a person must tender fulfillment of all obligations secured, plus certain expenses. If the entire balance of a secured obligation has been accelerated, it would be necessary to tender the entire balance. A tender of fulfillment obviously means more than a new promise to perform an existing promise. It requires payment in full of all monetary obligations then due and performance in full of all other obligations then matured. If unmatured secured obligations remain, the security interest continues to secure them (i.e., as if there had been no default).

3. **Redemption of Remaining Collateral Following Partial Enforcement.** Under section 9-610 a secured party may make successive dispositions of portions of its collateral. These dispositions would not affect the debtor's, another secured party's, or a lienholder's right to redeem the remaining collateral.

4. **Effect of "Repledging."** Section 9-207 generally permits a secured party having possession or control of collateral to create a security interest in the collateral. As explained in the comments to that section, the debtor's right (as opposed to its practical ability) to redeem collateral is not affected by, and does not affect, the priority of a security interest created by the debtor's secured party.

Legal Periodicals. — For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

CASE NOTES

Editor's Note. — *The case below was decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Public Policy. — The public policy of the State of North Carolina favors allowing debtors to redeem their property pledged as collateral, if possible, in order to protect their interest. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996), cert. granted, 345 N.C. 346, 483 S.E.2d 176 (1997).

Applied in In re Caple, — Bankr. —, 2005 Bankr. LEXIS 1094 (Bankr. M.D.N.C. Apr. 4, 2005).

§ 25-9-624. Waiver.

(a) Waiver of disposition notification. — A debtor or secondary obligor may waive the right to notification of disposition of collateral under G.S. 25-9-611 only by an agreement to that effect entered into and authenticated after default.

(b) Waiver of mandatory disposition. — A debtor may waive the right to require disposition of collateral under G.S. 25-9-620(e) only by an agreement to that effect entered into and authenticated after default.

(c) Waiver of redemption right. — Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under G.S. 25-9-623 only by an agreement to that effect entered into and authenticated after default. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former sections 9-504(3), 9-505, and 9-506.

2. **Waiver.** This section is a limited exception to section 9-602, which generally prohibits waiver by debtors and obligors. It makes no provision for waiver of the rule prohibiting a secured party from buying at its own private disposition. Transactions of this kind are equivalent to "strict foreclosures" and are governed by sections 9-620, 9-621, and 9-622.

Subpart 2. Noncompliance with Article.

§ 25-9-625. Remedies for secured party's failure to comply with Article.

(a) Judicial orders concerning noncompliance. — If it is established that a secured party is not proceeding in accordance with this article, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(b) Damages for noncompliance. — Subject to subsections (c), (d), and (f) of this section, a person is liable for damages in the amount of any loss caused by a failure to comply with this Article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

(c) Persons entitled to recover damages; statutory damages in consumer-goods transaction. — Except as otherwise provided in G.S. 25-9-628:

(1) A person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (b) of this section for its loss; and

(2) If the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this Part may recover for that failure in any event an amount not less than the credit service charge plus ten percent (10%) of the principal amount of the obligation or the time-price differential plus ten percent (10%) of the cash price.

(d) Recovery when deficiency eliminated or reduced. — A debtor whose deficiency is eliminated under G.S. 25-9-626 may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under G.S. 25-9-626 may not otherwise recover under subsection (b) of this section for noncompliance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance.

(e) Statutory damages: noncompliance with specified provisions. — In addition to any damages recoverable under subsection (b) of this section, the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover five hundred dollars ($500.00) in each case from a person that:

(1) Fails to comply with G.S. 25-9-208;

(2) Fails to comply with G.S. 25-9-209;

(3) Files a record that the person is not entitled to file under G.S. 25-9-509(a);

(4) Fails to cause the secured party of record to file or send a termination statement as required by G.S. 25-9-513(a) or (c);

(5) Fails to comply with G.S. 25-9-616(b)(1) and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or

(6) Fails to comply with G.S. 25-9-616(b)(2).

(f) Statutory damages: noncompliance with G.S. 25-9-210. — A debtor or consumer obligor may recover damages under subsection (b) of this section and, in addition, five hundred dollars ($500.00) in each case from a person that, without reasonable cause, fails to comply with a request under G.S. 25-9-210. A recipient of a request under G.S. 25-9-210 which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection.

(g) Limitation of security interest: noncompliance with G.S. 25-9-210. — If a secured party fails to comply with a request regarding a list of collateral or a statement of account under G.S. 25-9-210, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person that is reasonably misled by the failure. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-507.

2. **Remedies for Noncompliance; Scope.** Subsections (a) and (b) provide the basic remedies afforded to those aggrieved by a secured party's failure to comply with this article. Like all provisions that create liability, they are subject to section 9-628, which should be read in conjunction with section 9-605. The principal limitations under this part on a secured party's right to enforce its security interest against collateral are the requirements that it proceed in good faith (section 1-203), in a commercially reasonable manner (sections 9-607 and 9-610), and, in most cases, with reasonable notification (sections 9-611 through 9-614). Following former section 9-507, under subsection (a) an aggrieved person may seek injunctive relief, and under subsection (b) the person may recover damages for losses caused by noncompliance. Unlike former section 9-507, however, subsections (a) and (b) are not limited to noncompliance with provisions of this part of article 9. Rather, they apply to noncompliance with any provision of this article. The change makes this section applicable to noncompliance with sections 9-207 (duties of secured party in possession of collateral), 9-208 (duties of secured party having control over deposit account), 9-209 (duties of secured party if account debtor has been notified of an assignment), 9-210 (duty to comply with request for accounting, etc.), 9-509(a) (duty to refrain from filing unauthorized financing statement), and 9-513(a) (duty to provide termination statement). Subsection (a) also modifies the first sentence of former section 9-507(1) by adding the references to "collection" and "enforcement." Subsection (c)(2), which gives a minimum damage recovery in consumer goods transactions, applies only to noncompliance with the provisions of this part.

3. **Damages for Noncompliance with This Article.** Subsection (b) sets forth the basic remedy for failure to comply with the requirements of this article: A damage recovery in the amount of loss caused by the noncompliance. Subsection (c) identifies who may recover under subsection (b). It affords a remedy to any aggrieved person who is a debtor or obligor. However, a principal obligor who is not a debtor may recover damages only for noncompliance with section 9-616, inasmuch as none of the other rights and duties in this article run in favor of such a principal obligor. Such a principal obligor could not suffer any loss or damage on account of noncompliance with rights or duties of which it is not a beneficiary. Subsection (c) also affords a remedy to an aggrieved person who holds a competing security interest or other lien, regardless of whether the aggrieved person is entitled to notification under part 6. The remedy is available even to holders of senior security interests and other liens. The exercise of this remedy is subject to the normal rules of pleading and proof. A person who has delegated the duties of a secured party but who remains obligated to perform them is liable under this subsection. The last sentence of subsection (d) eliminates the possibility of double recovery or other over-compensation arising out of a reduction or elimination of a deficiency under section 9-626, based on noncompliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance. Assuming no double recovery, a debtor whose deficiency is eliminated under section 9-626 may pursue a claim for a surplus. Because section 9-626 does not apply to consumer transactions, the statute is silent as to whether a double recovery or other over-compensation is possible in a consumer transaction.

Damages for violation of the requirements of this article, including section 9-609, are those reasonably calculated to put an eligible claimant in the position that it would have occupied had no violation occurred. See section 1-106. Subsection (b) supports the recovery of actual damages for committing a breach of the peace in violation of section 9-609, and principles of tort law supplement this subsection. See section 1-103. However, to the extent that damages in tort compensate the debtor for the same loss dealt with by this article, the debtor should be entitled to only one recovery.

4. **Minimum Damages in Consumer-Goods Transactions.** Subsection (c)(2) provides a minimum, statutory, damage recovery for a debtor and secondary obligor in a consumer-goods transaction. It is patterned on former section 9-507(1) and is designed to ensure that every noncompliance with the requirements of part 6 in a consumer goods transaction results in liability, regardless of any injury that may have resulted. Subsection (c)(2) leaves the treatment of statutory damages as it was under former article 9. A secured party is not liable for statutory damages under this subsection more than once with respect to any one secured obligation (see section 9-628(e)), nor is a secured party liable under this subsection for failure to comply with section 9-616 (see section 9-628(d)).

Following former section 9-507(1), this article does not include a definition or explanation of the terms "credit service charge," "principal amount," "time-price differential," or "cash price," as used in subsection (c)(2). It leaves their construction and application to the court, taking into account the subsection's purpose of providing a minimum recovery in consumer-goods transactions.

5. **Supplemental Damages.** Subsections (e) and (f) provide damages that supplement the recovery, if any, under subsection (b). Subsection (e) imposes an additional $500 liability upon a person who fails to comply with the provisions specified in that subsection, and subsection (f) imposes like damages on a person who, without reasonable excuse, fails to comply with a request for an accounting or a request regarding a list of collateral or statement of account under section 9-210. However, under subsection (f), a person has a reasonable excuse for the failure if the person never claimed an interest in the collateral or obligations that were the subject of the request.

6. **Estoppel.** Subsection (g) limits the extent to which a secured party who fails to comply with a request regarding a list of collateral or statement of account may claim a security interest.

Legal Periodicals. — For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For survey of 1978 commercial law, see 57 N.C.L. Rev. 919 (1979).

For comment, "The Standard of Commercial Reasonableness in the Sale of Repossessed Collateral by Secured Creditors in North Carolina," see 15 Wake Forest L. Rev. 71 (1979).

For note on commercial reasonableness and the public sale in North Carolina, see 17 Wake Forest L. Rev. 153 (1981).

CASE NOTES

Editor's Note. — *The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Failure to Dispose of Collateral as Required Raises Presumption of Worth. — Creditor's failure to dispose of the collateral as required raises a presumption that the collateral was worth at least the amount of the debt. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

And places upon the creditor the burden of overcoming such presumption by proving the market value of the collateral by evidence other than the resale price. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

Creditor's Right to Deficiency Judgment. — Provision that a debtor has a right to recover from the creditor any loss caused by failure to comply with the Code contemplates the right to deficiency judgment by the creditor who fails to comply with the UCC provisions in disposing of the collateral. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

Creditor's Recovery by Deficiency Subject to Offset by Penalty. — If the debtor asserts damages or penalty against the creditor, the creditor's recovery by deficiency is subject to credit or offset by such damages or penalty. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

When Right to 10% of Principal Indebtedness Attaches. — Absolute right to recovery of 10% of the principal indebtedness only attaches when the collateral in question is consumer goods, rather than farm equipment. Church v. Mickler, 55 N.C. App. 724, 287 S.E.2d 131 (1982).

Mobile Home. — The trial court did not err by applying the consumer goods provision of former G.S. 25-9-507(1) to a case involving failure to give notice of sale of a mobile home. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Lender who repossessed car and transferred it to dealer under a repurchase agreement was not liable for the dealer's failure to sell the car within 90 days of repossession as required by former G.S. 25-9-505(1). Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

§ 25-9-626. Action in which deficiency or surplus is in issue.

(a) Applicable rules if amount of deficiency or surplus in issue. — In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

(1) A secured party need not prove compliance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue.

(2) If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with this Part.

(3) Except as otherwise provided in G.S. 25-9-628, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of:

a. The proceeds of the collection, enforcement, disposition, or acceptance; or

b. The amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance.

(4) For purposes of sub-subdivision (a)(3)b. of this section, the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.

(5) If a deficiency or surplus is calculated under G.S. 25-9-615(f), the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(b) Nonconsumer transactions; no inference. — The limitation of the rules in subsection (a) of this section to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope.** The basic damage remedy under section 9-625(b) is subject to the special rules in this section for transactions other than consumer transactions. This section addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced, disposed of, or accepted the collateral. It contains special rules applicable to a determination of the amount of a deficiency or surplus. Because this section affects a person's liability for a deficiency, it is subject to section 9-628, which should be read in conjunction with section 9-605. The rules in this section apply only to noncompliance in connection with the "collection, enforcement, disposition, or acceptance" under part 6. For other types of noncompliance with part 6, the general liability rule of section 9-625(b)—recovery of actual damages—applies. Consider, for example, a repossession that does not comply with section 9-609 for want of a default. The debtor's remedy is under section 9-625(b). In a proper case, the secured party also may be liable for conversion under non-UCC law. If the secured party thereafter disposed of the collateral, however, it would violate section 9-610 at that time, and this section would apply.

3. **Rebuttable Presumption Rule.** Section 9-626 establishes the rebuttable presumption rule for transactions other than consumer transactions. Under paragraph (1), the secured party need not prove compliance with the relevant provisions of this part as part of its prima facie case. If, however, the debtor or a secondary obligor raises the issue (in accordance with the forum's rules of pleading and practice), then

the secured party bears the burden of proving that the collection, enforcement, disposition, or acceptance complied. In the event the secured party is unable to meet this burden, then paragraph (3) explains how to calculate the deficiency. Under this rebuttable presumption rule, the debtor or obligor is to be credited with the greater of the actual proceeds of the disposition or the proceeds that would have been realized had the secured party complied with the relevant provisions. If a deficiency remains, then the secured party is entitled to recover it. The references to "the secured obligation, expenses, and attorney's fees" in paragraphs (3) and (4) embrace the application rules in sections 9-608(a) and 9-615(a).

Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, under paragraph (4) the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorney's fees. Thus, the secured party may not recover any deficiency unless it meets this burden.

4. **Consumer Transactions.** Although section 9-626 adopts a version of the rebuttable presumption rule for transactions other than consumer transactions, with certain exceptions part 6 does not specify the effect of a secured party's noncompliance in consumer transactions. (The exceptions are the provisions for the recovery of damages in section 9-625.) Subsection (b) provides that the limitation of subsection (a) (section 9-626) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. It also instructs the court not to draw any inference from the limitation as to the proper rules for consumer transactions and leaves the court free to continue to apply established approaches to those transactions.

Courts construing former section 9-507 disagreed about the consequences of a secured party's failure to comply with the requirements of former part 5. Three general approaches emerged. Some courts have held that a noncomplying secured party may not recover a deficiency (the "absolute bar" rule). A few courts held that the debtor can offset against a claim to a deficiency all damages recoverable under former section 9-507 resulting from the secured party's noncompliance (the "offset" rule). A plurality of courts considering the issue held that the noncomplying secured party is barred from recovering a deficiency unless it overcomes a rebuttable presumption that compliance with former part 5 would have yielded an amount sufficient to satisfy the secured debt. In addition to the nonuniformity resulting from court decisions, some states enacted special rules governing the availability of deficiencies.

5. **Burden of Proof When Section 9-615(f) Applies.** In a non-consumer transaction, paragraph (5) imposes upon a debtor or obligor the burden of proving that the proceeds of a disposition are so low that, under section 9-615(f), the actual proceeds should not serve as the basis upon which a deficiency or surplus is calculated. Were the burden placed on the secured party, then debtors might be encouraged to challenge the price received in every disposition to the secured party, a person related to the secured party, or a secondary obligor.

6. **Delay in Applying This Section.** There is an inevitable delay between the time a secured party engages in a noncomplying collection, enforcement, disposition, or acceptance and the time of a subsequent judicial determination that the secured party did not comply with part 6. During the interim, the secured party, believing that the secured obligation is larger than it ultimately is determined to be, may continue to enforce its security interest in collateral. If some or all of the secured indebtedness ultimately is discharged under this section, a reasonable application of this section would impose liability on the secured party for the amount of any excess, unwarranted recoveries but would not make the enforcement efforts wrongful.

§ 25-9-627. Determination of whether conduct was commercially reasonable.

(a) Greater amount obtainable under other circumstances; no preclusion of commercial reasonableness. — The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(b) Dispositions that are commercially reasonable. — A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) In the usual manner on any recognized market;
(2) At the price current in any recognized market at the time of the disposition; or
(3) Otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(c) Approval by court or on behalf of creditors. — A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:
(1) In a judicial proceeding;
(2) By a bona fide creditors' committee;
(3) By a representative of creditors; or
(4) By an assignee for the benefit of creditors.

(d) Approval under subsection (c) of this section not necessary; absence of approval has no effect. — Approval under subsection (c) of this section need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** Former section 9-507(2).

2. **Relationship of Price to Commercial Reasonableness.** Some observers have found the notion contained in subsection (a) (derived from former section 9-507(2)) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found in section 9-610(b) (derived from former section 9-504(3)) (every aspect of the disposition, including its terms, must be commercially reasonable). There is no such inconsistency. While not itself sufficient to establish a violation of this part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable.

The law long has grappled with the problem of dispositions of personal and real property which comply with applicable procedural requirements (e.g., advertising, notification to interested persons, etc.) but which yield a price that seems low. This article addresses that issue in section 9-615(f). That section applies only when the transferee is the secured party, a person related to the secured party, or a secondary obligor. It contains a special rule for calculating a deficiency or surplus in a complying disposition that yields a price that is "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought."

3. **Determination of Commercial Reasonableness; Advance Approval.** It is important to make clear the conduct and procedures that are commercially reasonable and to provide a secured party with the means of obtaining, by court order or negotiation with a creditors' committee or a representative of creditors, advance approval of a proposed method of enforcement as commercially reasonable. This section contains rules that assist in that determination and provides for advance approval in appropriate situations. However, none of the specific methods of disposition specified in subsection (b) is required or exclusive.

4. **"Recognized Market."** As in sections 9-610(c) and 9-611(d), the concept of a "recognized market" in subsections (b)(1) and (2) is quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

CASE NOTES

Editor's Note. *— The cases below were decided under former Article 9 of the Uniform Commercial Code prior to its revision by Session Laws 2000-169.*

Credit Against Debt Where Sale Not Commercially Reasonable. — Where sale is not conducted in a commercially reasonable manner, the debt is to be credited with the amount that reasonably should have been obtained through a sale conducted in a reasonably commercial manner according to the UCC. Hodges v. Norton, 29 N.C. App. 193, 223 S.E.2d 848 (1976).

Creditor Not Given Unbridled Discretion. — Former G.S. 25-9-507 (2) only prohibited second-guessing the secured party; it did not give him unbridled discretion. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

"Reasonable Commercial Practices" Ne-

cessitate Commercially Reasonable Price. — The sale of a single unit cannot be "in conformity with reasonable commercial practices among dealers" when the sale is for a commercially unreasonable price. In short, "reasonable commercial practices" necessitate a commercially reasonable price. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

But All Elements of Sale Must Be Considered Together. — There may be cases in which the price paid for the collateral will be commercially reasonable even though a higher price could have been obtained at a different time or in a different market. Nor is a price which is slightly inadequate necessarily commercially unreasonable. The trier of fact must consider all the elements of the sale together. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

Former § 25-9-507(2) did not make every inadequacy in price, however slight, commercially unreasonable. A truly gross inadequacy in price, however, if established by the evidence and believed by the jury, would support a finding that the sale was not "in conformity with reasonable commercial practices among dealers." Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

But Evidence of Gross Inadequacy Raises Issue of Reasonableness of Sale. — When the debtor offers independent evidence of a gross inadequacy of price, in North Carolina, that sufficiently raises the issue of the commercial reasonableness of the sale to take the case to the jury. Allis-Chalmers Corp. v. Davis, 37 N.C. App. 114, 245 S.E.2d 566 (1978).

Fact that the price obtained by a private sale was less than what the creditor's expert had estimated to be the fair market value of the unit did not make the sale commercially unreasonable where the final sale price was representative of the condition of th mobile home and was relative to other prices obtained on comparable mobile homes. In re Marshall, 219 Bankr. 687 (Bankr. M.D.N.C. 1997).

§ 25-9-628. Nonliability and limitation on liability of secured party; liability of secondary obligor.

(a) Limitation of liability of secured party for noncompliance with Article. — Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(1) The secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this Article; and

(2) The secured party's failure to comply with this Article does not affect the liability of the person for a deficiency.

(b) Limitation of liability based on status as secured party. — A secured party is not liable because of its status as secured party:

(1) To a person that is a debtor or obligor, unless the secured party knows:
  a. That the person is a debtor or obligor;
  b. The identity of the person; and
  c. How to communicate with the person; or

(2) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:
  a. That the person is a debtor; and
  b. The identity of the person.

(c) Limitation of liability if reasonable belief that transaction not a consumer-goods transaction or consumer transaction. — A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on:

(1) A debtor's representation concerning the purpose for which collateral was to be used, acquired, or held; or

(2) An obligor's representation concerning the purpose for which a secured obligation was incurred.

(d) Limitation of liability for statutory damages. — A secured party is not liable to any person under G.S. 25-9-625(c)(2) for its failure to comply with G.S. 25-9-616.

(e) Limitation of multiple liability for statutory damages. — A secured party is not liable under G.S. 25-9-625(c)(2) more than once with respect to any one secured obligation. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Source.** New.

2. **Exculpatory Provisions.** Subsections (a), (b), and (c) contain exculpatory provisions that should be read in conjunction with section 9-605. Without this group of provisions, a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself. The broadened definition of the term "debtor" underscores the need for these provisions.

If a secured party reasonably, but mistakenly, believes that a consumer transaction or consumer-goods transaction is a non-consumer transaction or non-consumer-goods transaction, and if the secured party's belief is based on its reasonable reliance on a representation of the type specified in subsection (c)(1) or (c)(2), then this article should be applied as if the facts reasonably believed and the representation reasonably relied upon were true. For example, if a secured party reasonably believed that a transaction was a non-consumer transaction and its belief was based on reasonable reliance on the debtor's representation that the collateral secured an obligation incurred for business purposes, the secured party is not liable to any person, and the debtor's liability for a deficiency is not affected, because of any act or omission of the secured party which arises out of the reasonable belief. Of course, if the secured party's belief is not reasonable or, even if reasonable, is not based on reasonable reliance on the debtor's representation, this limitation on liability is inapplicable.

3. **Inapplicability of Statutory Damages to Section 9-616.** Subsection (d) excludes noncompliance with section 9-616 entirely from the scope of statutory damage liability under section 9-625(c)(2).

4. **Single Liability for Statutory Minimum Damages.** Subsection (e) ensures that a secured party will incur statutory damages only once in connection with any one secured obligation.

PART 7

TRANSITION.

§ 25-9-701. Effective date.

This act takes effect on July 1, 2001. References in this Part to "this act" refer to PARTS I, II, and III of the session law by which this Part is added to Article 9 of Chapter 25 of the General Statutes. References in this Part to "former Article 9" are to Article 9 of Chapter 25 of the General Statutes as in effect immediately before July 1, 2001. (2000-169, s. 1.)

OFFICIAL COMMENT

A uniform law as complex as article 9 necessarily gives rise to difficult problems and uncertainties during the transition to the new law. As is customary for uniform laws, this article is based on the general assumption that all states will have enacted substantially identical versions. While always important, uniformity is essential to the success of this article. If former article 9 is in effect in some jurisdictions, and this article is in effect in others, horrendous complications may arise. For example, the proper place in which to file to perfect a security interest (and thus the status of a particular security interest as perfected or unperfected) would depend on whether the matter was litigated in a state in which former article 9 was in effect or a state in which this article was in effect. Accordingly, this section contemplates that states will adopt a uniform effective date for this article. Any one state's failure to adopt the uniform effective date will greatly increase the cost and uncertainty surrounding the transition.

Other problems arise from transactions and relationships that were entered into under former article 9 or under non-UCC law and which remain outstanding on the effective date of this article. The difficulties arise primarily because this article expands the scope of former article 9 to cover additional types of collateral and transactions and because it provides new methods of perfection for some types of collateral, different priority rules, and different choice of law rules governing perfection and priority. This section and the other sections in this part address primarily this second set of problems.

NORTH CAROLINA COMMENT

This section is modified by adding the last two sentences.

CASE NOTES

Applied in Miller v. Van Dorn Demag Corp. (In re Asheboro Precision Plastics, Inc.), — Bankr. —, 2005 Bankr. LEXIS 1091 (Bankr. M.D.N.C. Mar. 1, 2005).

§ 25-9-702. Savings clause.

(a) Pre-effective-date transactions or liens. — Except as otherwise provided in this Part, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before July 1, 2001.

(b) Continuing validity. — Except as otherwise provided in subsection (c) of this section and G.S. 25-9-703 through G.S. 25-9-709:

(1) Transactions and liens that were not governed by former Article 9, were validly entered into or created before July 1, 2001, and would be subject to this act if they had been entered into or created after July 1, 2001, and the rights, duties, and interests flowing from those transactions and liens remain valid after July 1, 2001; and

(2) The transactions and liens described in subdivision (1) of this subsection may be terminated, completed, consummated, and enforced as required or permitted by this act or by the law that otherwise would apply if this act had not taken effect.

(c) Pre-effective-date proceedings. — This act does not affect an action, case, or proceeding commenced before July 1, 2001.

(d) Special rule for certain governmental transactions. — Notwithstanding any other provision of this act, security interests that were excluded under former Article 9 pursuant to former G.S. 25-9-104(e) or as to which the filing requirements of former Article 9 did not apply pursuant to former G.S. 25-9-302(6), and which are effective prior to July 1, 2001, but for which the applicable requirements for creation, perfection, or enforceability under this act are not satisfied on July 1, 2001, shall nonetheless be treated as valid, enforceable, and perfected security interests under this act for the duration of those security interests. (2000-169, s. 1; 2001-218, s. 4.)

OFFICIAL COMMENT

1. **Pre-Effective-Date Transactions.** Subsection (a) contains the general rule that this article applies to transactions, security interests, and other liens within its scope (see section 9-109), even if the transaction or lien was entered into or created before the effective date. Thus, secured transactions entered into under former article 9 must be terminated, completed, consummated, and enforced under this article. Subsection (b) is an exception to the general rule. It applies to valid, pre-effective-date transactions and liens that were not governed by former article 9 but would be governed by this article if they had been entered into or created after this Article takes effect. Under subsection (b), these valid transactions, such as the creation of agricultural liens and security interests in commercial tort claims, retain their validity under this article and may be terminated, completed, consummated, and enforced under this article. However, these transactions also may be terminated, completed, consummated, and enforced by the law that otherwise would apply had this article not taken effect.

2. **Judicial Proceedings Commenced Before Effective Date.** As is usual in transition

provisions, subsection (c) provides that this article does not affect litigation pending on the effective date.

NORTH CAROLINA COMMENT

Subdivision (b)(2) is modified by inserting the phrase "described in subdivision (1) of this subsection." Subsection (d) has no counterpart in the uniform text.

The intent of the special public finance-related transition rule added by subsection (d) is that security interests created prior to July 1, 2001, and not subject to former Article 9 through the specified provisions thereof will remain exempt from this Article after that date. Security interests that are subject to former Article 9 and created in connection with transactions involving governmental units prior to July 1, 2001, will either be (a) of a type not subject to this Article, in which case no action need be taken, or (b) of a type that is subject to this Article, in which case G.S. 25-9-703 through G.S. 25-9-709 are applicable thereto.

§ 25-9-703. Security interest perfected before effective date.

(a) Continuing priority over lien creditor: perfection requirements satisfied. — A security interest that is enforceable immediately before July 1, 2001 and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this act if, on July 1, 2001, the applicable requirements for enforceability and perfection under this act are satisfied without further action.

(b) Continuing priority over lien creditor: perfection requirements not satisfied. — Except as otherwise provided in G.S. 25-9-705, if, immediately before July 1, 2001, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this act are not satisfied on July 1, 2001, the security interest:

(1) Is a perfected security interest for one year after July 1, 2001;
(2) Remains enforceable thereafter only if the security interest becomes enforceable under G.S. 25-9-203 before the year expires; and
(3) Remains perfected thereafter only if the applicable requirements for perfection under this act are satisfied before the year expires. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Perfected Security Interests Under Former Article 9 and This Article.** This section deals with security interests that are perfected (i.e., that are enforceable and have priority over the rights of a lien creditor) under former article 9 or other applicable law immediately before this article takes effect. Subsection (a) provides, not surprisingly, that if the security interest would be a perfected security interest under this article (i.e., if the transaction satisfies this article's requirements for enforceability (attachment) and perfection), no further action need be taken for the security interest to be a perfected security interest.

2. **Security Interests Enforceable and Perfected Under Former Article 9 but Unenforceable or Unperfected Under This Article.** Subsection (b) deals with security interests that are enforceable and perfected under former article 9 or other applicable law immediately before this Article takes effect but do not satisfy the requirements for enforceability (attachment) or perfection under this article. Except as otherwise provided in section 9-705, these security interests are perfected security interests for one year after the effective date. If the security interest satisfies the requirements for attachment and perfection within that period, the security interest remains perfected thereafter. If the security interest satisfies only the requirements for attachment within that period, the security interest becomes unperfected at the end of the one-year period.

Example 1: A pre-effective-date security agreement in a consumer transaction covers "all securities accounts." The security interest is properly perfected. The collateral description was adequate under former article 9 (see former section 9-115(3)) but is insufficient under this article (see section 9-108(e)(2)). Unless the debtor authenticates a new security agreement describing the collateral other than by "type" (or section 9-203(b)(3) otherwise is satisfied) within the one-year period following the effective date, the security interest becomes unenforceable at the end of that period.

Other examples under former article 9 or other applicable law that may be effective as attachment or enforceability steps but may be ineffective under this article include an oral agreement to sell a payment intangible or possession by virtue of a notification to a bailee under former section 9-305. Neither the oral agreement nor the notification would satisfy the revised section 9-203 requirements for attachment.

Example 2: A pre-effective-date possessory security interest in instruments is perfected by a bailee's receipt of notification under former section 9-305. The bailee has not, however, acknowledged that it holds for the secured party's benefit under revised section 9-313. Unless the bailee authenticates a record acknowledging that it holds for the secured party (or another appropriate perfection step is taken) within the one-year period following the effective date, the security interest becomes unperfected at the end of that period.

3. **Interpretation of Pre-Effective-Date Security Agreements.** Section 9-102 defines "security agreement" as "an agreement that creates or provides for a security interest." Under section 1-201(3), an "agreement" is a "bargain of the parties in fact." If parties to a pre-effective-date security agreement describe the collateral by using a term defined in former article 9 in one way and defined in this article in another way, in most cases it should be presumed that the bargain of the parties contemplated the meaning of the term under former article 9.

Example 3: A pre-effective-date security agreement covers "all accounts" of a debtor. As defined under former article 9, an "account" did not include a right to payment for lottery winnings. These rights to payment are "accounts" under this article, however. The agreement of the parties presumptively created a security interest in "accounts" as defined in former article 9. A different result might be appropriate, for example, if the security agreement explicitly contemplated future changes in the article 9 definitions of types of collateral—e.g., "'Accounts' means 'accounts' as defined in the UCC article 9 of (State X), as that definition may be amended from time to time." Whether a different approach is appropriate in any given case depends on the bargain of the parties, as determined by applying ordinary principles of contract construction.

§ 25-9-704. Security interest unperfected before effective date.

A security interest that is enforceable immediately before July 1, 2001 but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) Remains an enforceable security interest for one year after July 1, 2001;

(2) Remains enforceable thereafter if the security interest becomes enforceable under G.S. 25-9-203 on July 1, 2001 or within one year thereafter; and

(3) Becomes perfected:

  a. Without further action, on July 1, 2001 if the applicable requirements for perfection under this act are satisfied before or at that time; or

  b. When the applicable requirements for perfection are satisfied if the requirements are satisfied after that time. (2000-169, s. 1.)

OFFICIAL COMMENT

This section deals with security interests that are enforceable but unperfected (i.e., subordinate to the rights of a person who becomes a lien creditor) under former article 9 or other applicable law immediately before this Article takes effect. These security interests remain enforceable for one year after the effective date, and thereafter if the appropriate steps for attachment under this article are taken before the one-year period expires. (This section's treatment of enforceability is the same as that of section 9-703.) The security interest becomes a perfected security interest on the effective date if, at that time, the security interest satisfies the requirements for perfection under this article. If the security interest does not satisfy the requirements for perfection until sometime thereafter, it becomes a perfected security interest at that later time.

Example: A security interest has attached under former article 9 but is unperfected because the filed financing statement covers "all of debtor's personal property" and controlling case law in the applicable jurisdiction has determined that this identification of collateral in a financing statement is insufficient. Upon the effective date of this Article, the financing statement becomes sufficient under section 9-504(2). On that date the security interest becomes perfected. (This assumes, of course, that the financing statement is filed in the proper filing office under this article.)

§ 25-9-705. Effectiveness of action taken before effective date.

(a) Pre-effective-date action; one-year perfection period unless reperfected. — If action, other than the filing of a financing statement, is taken before July 1, 2001 and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before July 1, 2001, the action is effective to perfect a security interest that attaches under this act within one year after July 1, 2001. An attached security interest becomes unperfected one year after July 1, 2001 unless the security interest becomes a perfected security interest under this act before the expiration of that period.

(b) Pre-effective-date filing. — The filing of a financing statement before July 1, 2001 is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this act.

(c) Pre-effective-date filing in jurisdiction formerly governing perfection. — This act does not render ineffective an effective financing statement that, before July 1, 2001, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in G.S. 25-9-103 of former Article 9. However, except as otherwise provided in subsections (d), (e), and (g) of this section and G.S. 25-9-706, the financing statement ceases to be effective at the earlier of:

(1) The time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(d) Continuation statement. — The filing of a continuation statement after July 1, 2001 does not continue the effectiveness of the financing statement filed before July 1, 2001. However, upon the timely filing of a continuation statement after July 1, 2001 and in accordance with the law of the jurisdiction governing perfection as provided in Part 3 of this Article, the effectiveness of a financing statement filed in the same office in that jurisdiction before July 1, 2001 continues for the period provided by the law of that jurisdiction.

(e) Application of subdivision (c)(2) to transmitting utility financing statement. — Subdivision (c)(2) of this section applies to a financing statement that, before July 1, 2001, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in G.S. 25-9-103 of former Article 9 only to the extent that Part 3 of this Article provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) Application of Part 5. — A financing statement that includes a financing statement filed before July 1, 2001 and a continuation statement filed after July 1, 2001 is effective only to the extent that it satisfies the requirements of Part 5 of this Article for an initial financing statement.

(g) Inapplicability of subdivision (c)(2) to certain financing statements. — With respect to an effective financing statement that:

(1) Before July 1, 2001, was filed and satisfied the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in G.S. 25-9-103 of former Article 9,
(2) Would satisfy the applicable requirements for perfection under this act, and
(3) Was properly continued before July 1, 2001, such that the effectiveness of the financing statement would lapse after June 30, 2006, but before January 1, 2007, but for subdivision (c)(2) of this section,

subdivision (c)(2) of this section shall not apply to the financing statement and the filing of a continuation statement with respect to the financing statement is timely if the filing of the continuation statement occurs before the financing statement ceases to be effective and not before the earlier of (i) December 30, 2005, or (ii) six months before the effectiveness of the financing statement would lapse. (2000-169, s. 1; 2001-487, s. 15; 2006-11, s. 1.)

OFFICIAL COMMENT

1. **General.** This section addresses primarily the situation in which the perfection step is taken under former article 9 or other applicable law before the effective date of this Article, but the security interest does not attach until after that date.

2. **Perfection Other Than by Filing.** Subsection (a) applies when the perfection step is a step other than the filing of a financing statement. If the step that would be a valid perfection step under former article 9 or other law is taken before this Article takes effect, and if a security interest attaches within one year after this Article takes effect, then the security interest becomes a perfected security interest upon attachment. However, the security interest becomes unperfected one year after the effective date unless the requirements for attachment and perfection under this article are satisfied within that period.

3. **Perfection by Filing: Ineffective Filings Made Effective.** Subsection (b) deals with financing statements that were filed under former article 9 and which would not have perfected a security interest under the former article (because, e.g., they did not accurately describe the collateral or were filed in the wrong place), but which would perfect a security interest under this article. Under subsection (b), such a financing statement is effective to perfect a security interest to the extent it complies with this article. Subsection (b) applies regardless of the reason for the filing. For example, a secured party need not wait until the effective date to respond to the change this article makes with respect to the jurisdiction whose law governs perfection of certain security interests. Rather, a secured party may wish to prepare for this change by filing a financing statement before the effective date in the jurisdiction whose law governs perfection under this article. When this Article takes effect, the filing becomes effective to perfect a security interest (assuming the filing satisfies the perfection requirements of this article). Note, however, that section 9-706 determines whether a financing statement filed before the effective date operates to continue the effectiveness of a financing statement filed in another office before the effective date.

4. **Perfection by Filing: Change in Applicable Law or Filing Office.** Subsection (c) provides that a financing statement filed in the proper jurisdiction under former section 9-103 remains effective for all purposes, despite the fact that this article would require filing of a financing statement in a different jurisdiction or in a different office in the same jurisdiction. This means that, during the early years of this article's effectiveness, it may be necessary to search not only in the filing office of the jurisdiction whose law governs perfection under this article but also (if different) in the jurisdiction(s) and filing office(s) designated by former article 9. To limit this burden, subsection (c) provides that a financing statement filed in the jurisdiction determined by former section 9-103 becomes ineffective at the earlier of the time it would become ineffective under the law of that jurisdiction or June 30, 2006. The June 30, 2006, limitation addresses some nonuniform versions of former article 9 that extended the effectiveness of a financing statement beyond five years. Note that a financing statement filed before the effective date may remain effective beyond June 30, 2006, if subsection (d) (concerning continuation statements) or (e) (concerning transmitting utilities) or section 9-706 (concerning initial financing statements that operate to continue pre-effective-date financing statements) so provides.

Subsection (c) is an exception to section 9-703(b). Under the general rule in section 9-703(b), a security interest that is enforceable and perfected on the effective date of this Article is a perfected security interest for one year after this article takes effect, even if the security interest is not enforceable under this article and the applicable requirements for perfection under this article have not been met. However, in some cases subsection (c) may shorten the one-year period of perfection; in others, if the security interest is enforceable under section 9-203, it may extend the period of perfection.

Example 1: On July 3, 1996, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On July 6, 1996, SP perfects a security interest in the equipment under former article 9 by filing in the office of the State Y Secretary of State. See former section 9-103(1)(b). This article takes effect in States X and Y on July 1, 2001. Under section 9-705(c), the financing statement remains effective until it lapses in July 2001. See former section 9-403. Had SP continued the effectiveness of the financing statement by filing a continuation statement in State Y under former article 9 before July 1, 2001, the financing statement would have remained effective to perfect the security interest through June 30, 2006. See subsection (c)(2). Alternatively, SP could have filed an initial financing statement in State X under subsection (b) or section 9-706 before the State Y financing statement lapsed. Had SP done so, the security interest would have remained perfected without interruption until the State X financing statement lapsed.

5. **Continuing Effectiveness of Filed Financing Statement.** A financing statement filed before the effective date of this Article may be continued only by filing in the state and office designated by this article. This result is accomplished in the following manner: Subsection (d) indicates that, as a general matter, a continuation statement filed after the effective date of this Article does not continue the effectiveness of a financing statement filed under the law designated by former section 9-103. Instead, an initial financing statement must be filed under section 9-706. The second sentence of subsection (d) contains an exception to the general rule. It provides that a continuation statement is effective to continue the effectiveness of a financing statement filed before this Article takes effect if this article prescribes not only the same jurisdiction but also the same filing office.

Example 2: On November 8, 2000, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On November 15, 2000, SP perfects a security interest in the equipment under former article 9 by filing in the office of the State Y Secretary of State. See former section 9-103(1)(b). This article takes effect in States X and Y on July 1, 2001. Under section 9-705(c), the financing statement ceases to be effective in November, 2005, when it lapses. See section 9-515. Under this article, the law of D's location (State X, see section 9-307) governs perfection. See section 9-301. Thus, the filing of a continuation statement in State Y on or after July 1, 2001, would not continue the effectiveness of the financing statement. See subsection (d). However, the effectiveness of the financing statement could be continued under section 9-706.

Example 3: The facts are as in Example 2, except that D is a State Y corporation. Assume State Y adopted former section 9-401(1) (second alternative). State Y law governs perfection under part 3 of this article. (See sections 9-301 and 9-307.) Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y continues the effectiveness of the financing statement.

Example 4: The facts are as in Example 3, except that the collateral is equipment used in farming operations and, in accordance with former section 9-401(1) (second alternative) as enacted in State Y, the financing statement was filed in State Y, in the office of the Shelby County Recorder of Deeds. Under this article, a continuation statement must be filed in the office of the State Y Secretary of State. See section 9-501(a)(2). Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y operates to continue a pre-effective-date financing statement only if the continuation statement is filed in the same office as the financing statement. Accordingly, the continuation statement is not effective in this case, but the financing statement may be continued under section 9-706.

Example 5: The facts are as in Example 3, except that State Y enacted former section 9-401(1) (third alternative). As required by former section 9-401(1), SP filed financing statements in both the office of the State Y Secretary of State and the office of the Shelby County Recorder of Deeds. Under this article, a continuation statement must be filed in the office of the State Y Secretary of State. See section 9-501(a)(2). The timely filing of a continuation statement in that office after this Article takes effect would be effective to continue the effectiveness of the financing statement (and thus continue the perfection of the security interest), even if the financing statement filed with the county recorder lapses.

6. **Continuation Statements.** In some cases, this article reclassifies collateral covered by a financing statement filed under former article 9. For example, collateral consisting of the right to payment for real property sold would be a "general intangible" under the former article but an "account" under this article. To continue perfection under those circum-

stances, a continuation statement must comply with the normal requirements for a continuation statement. See section 9-515. In addition, the pre-effective-date financing statement and continuation statement, taken together, must satisfy the requirements of this article concerning the sufficiency of the debtor's name, secured party's name, and indication of collateral. See subsection (f).

Example 6: A pre-effective-date financing statement covers "all general intangibles" of a debtor. As defined under former article 9, a "general intangible," would include rights to payment for lottery winnings. These rights to payment are "accounts" under this article, however. A post-effective-date continuation statement will not continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings unless it amends the indication of collateral covered to include lottery winnings (e.g., by adding "accounts," "rights to payment for lottery winnings," or the like). If the continuation statement does not amend the indication of collateral, the continuation statement will be effective to continue the effectiveness of the financing statement only with respect to "general intangibles" as defined in this article.

Example 7: The facts are as in Example 6, except that the pre-effective-date financing statement covers "all accounts and general intangibles." Even though rights to payment for lottery winnings are "general intangibles" under former Article 9 and "accounts" under this Article, a post-effective-date continuation statement would continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings. There would be no need to amend the indication of collateral covered, inasmuch as the indication ("accounts") satisfies the requirements of this article.

NORTH CAROLINA COMMENT (2006)

S.L. 2006-11 amended this section by adding subsection (g), which is intended to address certain interpretive issues concerning the application of this section to a narrow class of "affected" financing statements. The "affected" financing statements are those financing statements that (i) were properly filed in this State before July 1, 2001, (ii) satisfied the applicable requirements of filing and perfection under former Article 9, (iii) also satisfy the applicable requirements of filing and perfection under this Article, (iv) were properly continued in this State before July 1, 2001, (a "same state" continuation), and (v) would lapse after June 30, 2006, but prior to January 1, 2007.

Under subsection (c), a financing statement that was filed under former Article 9 and that satisfied the requirements for perfection under former Article 9 ceases to be effective at the earlier of (i) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed (i.e. its normal lapse date) or (ii) June 30, 2006. This would cause all "affected" financing statements to become ineffective on June 30, 2006, regardless of their actual lapse date. For example, an "affected" financing statement that would otherwise cease to be effective under the laws of this State on November 1, 2006, would actually cease to be effective on June 30, 2006. This result would be obtained unless subsection (b) applied to override subsection (c). Although it first appears that subsection (b) would validate a pre-effective-date filing under this Article, the Official Comment to subsection (b) indicates that the subsection deals with a different set of circumstances that do not include "same state" continuations. Therefore, it is unclear whether subsection (b) applies to an "affected" financing statement. This uncertainty, in turn, leads to further uncertainty regarding the manner of application to "affected" financing statements of the six-month window within which a continuation statement may be filed under G.S. 25-9-515(d). Is the correct measurement of this window the six-month period immediately prior to the November 1, 2006, lapse date or the six-month period immediately preceding June 30, 2006?

New subsection (g) is intended to resolve any interpretive ambiguity. The subsection is intended to (i) apply only to "affected" financing statements, (ii) make it clearer that subdivision (c)(2) does not apply to "affected" financing statements, (iii) assure effectiveness not only of continuation statements filed after the effective date of subsection (g), but also those filed on and after December 30, 2005, and prior to the effective date of subsection (g), and (iv) avoid the necessity of making a determination whether or not subsection (b) applies to "same state" continuations.

Subsection (g) is not intended to address any other interpretive issue and nor does it render ineffective a continuation statement that was filed and effective before the effective date of subsection (g).

Editor's Note. — Session Laws 2006-11, s. 2, provides: "Nothing in this act renders ineffective a continuation statement that was filed and effective before the effective date of this act."

Session Laws 2006-226, s. 33, amended Session Laws 2006-11 by enacting a new section of that act to read: "Section 2.1. The Revisor of Statutes shall cause to be printed along with G.S. 25-9-705, as amended by this act, all explanatory comments of the drafters of this act as the Revisor deems appropriate."

Effect of Amendments. — Session Laws 2006-11, s. 1, effective June 14, 2006, in subsection (c), substituted "(d), (e), and (g)" for "(d) and (e)"; and added subsection (g).

§ 25-9-706. When initial financing statement suffices to continue effectiveness of financing statement.

(a) Initial financing statement in lieu of continuation statement. — The filing of an initial financing statement in the office specified in G.S. 25-9-501 continues the effectiveness of a financing statement filed before July 1, 2001 if:

(1) The filing of an initial financing statement in that office would be effective to perfect a security interest under this act;

(2) The pre-effective-date financing statement was filed in an office in another state or another office in this State; and

(3) The initial financing statement satisfies subsection (c) of this section.

(b) Period of continued effectiveness. — The filing of an initial financing statement under subsection (a) of this section continues the effectiveness of the pre-effective-date financing statement:

(1) If the initial financing statement is filed before July 1, 2001, for the period provided in G.S. 25-9-403 of former Article 9 with respect to a financing statement; and

(2) If the initial financing statement is filed after July 1, 2001, for the period provided in G.S. 25-9-515 with respect to an initial financing statement.

(c) Requirement for initial financing statement under subsection (a). — To be effective for purposes of subsection (a) of this section, an initial financing statement must:

(1) Satisfy the requirements of Part 5 of this Article for an initial financing statement;

(2) Identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and

(3) Indicate that the pre-effective-date financing statement remains effective. (2000-169, s. 1.)

AMENDED OFFICIAL COMMENT (2001 EDITION)

Editor's Note.

The Amended Official Comment (2001 Edition) is set out below to correct the Official Comment appearing in the main volume.

1. **Continuation of Financing Statements Not Filed in Proper Filing Office Under This Article.** This section deals with continuing the effectiveness of financing statements that are filed in the proper state and office under former article 9, but which would be filed in the wrong state or in the wrong office of the proper state under this article. Section 9-705(d) provides that, under these circumstances, filing a continuation statement after the effective date of this article in the office designated by former article 9 would not be effective. This section provides the means by which the effectiveness of such a financing statement can be continued if this article governs perfection under the applicable choice of law rule: Filing an initial financing statement in the office specified by section 9-501.

Although it has the effect of continuing the effectiveness of a pre-effective-date financing statement, an initial financing statement described in this section is not a continuation statement. Rather, it is governed by the rules applicable to initial financing statements.

(However, the debtor need not authorize the filing. See section 9-708.) Unlike a continuation statement, the initial financing statement described in this section may be filed any time during the effectiveness of the pre-effective-date financing statement—even before this article is enacted—and not only within the six months immediately prior to lapse. In contrast to a continuation statement, which extends the lapse date of a filed financing statement for five years, the initial financing statement has its own lapse date, which bears no relation to the lapse date of the pre-effective-date financing statement whose effectiveness the initial financing statement continues. See subsection (b).

As subsection (a) makes clear, the filing of an initial financing statement under this section continues the effectiveness of a pre-effective-date financing statement. If the effectiveness of a pre-effective-date financing statement lapses before the initial financing statement is filed, the effectiveness of the pre-effective-date financing statement cannot be continued. Rather, unless the security interest is perfected otherwise, there will be a period during which the security interest is unperfected before becoming perfected again by the filing of the initial financing statement under this section.

If an initial financing statement is filed under this section before the effective date of this Article, it takes effect when this Article takes effect (assuming that it is ineffective under former article 9). Note, however, that former article 9 determines whether the filing office is obligated to accept such an initial financing statement. For the reason given in the preceding paragraph, an initial financing statement filed before the effective date of this Article does not continue the effectiveness of a pre-effective-date financing statement unless the latter remains effective on the effective date of this Article. Thus, for example, if the effectiveness of the pre-effective-date financing statement lapses before this Article takes effect, the initial financing statement would not continue its effectiveness.

2. **Requirements of Initial Financing Statement Filed in Lieu of Continuation Statement.** Subsection (c) sets forth the requirements for the initial financing statement under subsection (a). These requirements are needed to inform searchers that the initial financing statement operates to continue a financing statement filed elsewhere and to enable searchers to locate and discover the attributes of the other financing statement. A single initial financing statement may continue the effectiveness of more than one financing statement filed before this Article's effective date. See section 1-102(5)(a) (words in the singular include the plural). If a financing statement has been filed in more than one office in a given jurisdiction, as may be the case if the jurisdiction had adopted former Section 9-401(1), third alternative, then an identification of the filing in the central filing office suffices for purposes of subsection (c)(2). If under this article the collateral is of a type different from its type under former article 9—as would be the case, e.g., with a right to payment of lottery winnings (a "general intangible" under former article 9 and an "account" under this article), then subsection (c) requires that the initial financing statement indicate the type under this article.

§ 25-9-707. Amendment of pre-effective-date financing statement.

(a) "Pre-effective-date financing statement". — In this section, "pre-effective-date financing statement" means a financing statement filed before July 1, 2001.

(b) Applicable law. — After July 1, 2001, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in Part 3 of this Article. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) Method of amending: general rule. — Except as otherwise provided in subsection (d) of this section, if the law of this State governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after July 1, 2001 only if:

(1) The pre-effective-date financing statement and an amendment are filed in the office specified in G.S. 25-9-501;

(2) An amendment is filed in the office specified in G.S. 25-9-501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies G.S. 25-9-706(c); or

(3) An initial financing statement that provides the information as amended and satisfies G.S. 25-9-706(c) is filed in the office specified in G.S. 25-9-501.

(d) Method of amending: continuation. — If the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under G.S. 25-9-705(d) and (f) or G.S. 25-9-706.

(e) Method of amending: additional termination rule. — Whether or not the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this State may be terminated after July 1, 2001, by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies G.S. 25-9-706(c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in Part 3 of this Article as the office in which to file a financing statement. However, a termination statement shall not be filed under this section in the register of deeds office unless it is the office specified in G.S. 25-9-501.

(f) No additional fee. — No separate fee shall be charged for the filing or indexing of a concurrently filed termination statement under subdivision (c)(2) of this section. (2000-169, s. 1; 2001-231, s. 6.)

OFFICIAL COMMENT

1. Scope of This Section. This section addresses post-effective-date amendments to pre-effective-date financing statements.

2. Applicable Law. Determining how to amend a pre-effective-date financing statement requires one first to determine the jurisdiction whose law applies. Subsection (b) provides that, as a general matter, post-effective-date amendments to pre-effective-date financing statements are effective only if they are accomplished in accordance with the substantive (or local) law of the jurisdiction governing perfection under Part 3 of this Article. However, under certain circumstances, the effectiveness of a financing statement may be terminated in accordance with the substantive law of the jurisdiction in which the financing statement is filed. See Comment 5, below.

Example 1: D is a corporation organized under the law of State Y. It owns equipment located in State X. Under former Article 9, SP properly perfected a security interest in the equipment by filing a financing statement in State X. Under this Article, the law of State Y governs perfection of the security interest. See Sections 9-301, 9-307. After this Article takes effect, SP wishes to amend the financing statement to reflect a change in D's name. Under subsection (b), the financing statement may be amended in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y.

Example 2: The facts are as in Example 1, except that SP wishes to terminate the effectiveness of the State X filing. The first sentence of subsection (b) provides that the financing statement may be terminated after the effective date of this Article in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y. However, the second sentence provides that the financing statement also may be terminated in accordance with the law of the jurisdiction in which it is filed, i.e., in accordance with subsection (e) as enacted in State X. If the pre-effective-date financing statement is filed in the jurisdiction whose law governs perfection (here, State Y), then both sentences would designate the law of State Y as applicable to the termination of the financing statement. That is, the financing statement could be terminated in accordance with subsection (c) or (e) as enacted in State Y.

3. Method of Amending. Subsection (c) provides three methods of effectuating a post-effective-date amendment to a pre-effective-date financing statement. Under subsection (c)(1), if the financing statement is filed in the jurisdiction and office determined by this Article, then an effective amendment may be filed in the same office.

Example 3: D is a corporation organized under the law of State Z. It owns equipment located in State Z. Before the effective date of this Article, SP perfected a security interest in the equipment by filing in two offices in State Z, a local filing office and the office of the Secretary of State. See former Section 9-401(1) (third alternative). State Z enacts this Article and specifies in Section 9-501 that a financing statement covering equipment is to be filed in the office of the Secretary of State. SP wishes to assign its power as secured party of record. Under subsection (b), the substantive law of State Z applies. Because the pre-effective-date financing statement is filed in the office specified in subsection (c)(1) as enacted by State Z, SP may effectuate the assignment by filing an amendment under Section 9-514 with the office of the Secretary of State. SP need not amend the local filing, and the priority of the security interest perfected by the filing of the financing statement would not be affected by the failure to amend the local filing.

If a pre-effective-date financing statement is filed in an office other than the one specified by Section 9-501 of the relevant jurisdiction, then ordinarily an amendment filed in that office is ineffective. (Subsection (e) provides an exception for termination statements.) Rather, the amendment must be effectuated by a filing in the jurisdiction and office determined by this Article. That filing may consist of an initial financing statement followed by an amendment, an initial financing statement together with an amendment, or an initial financing statement that indicates the information provided in the financing statement, as amended. Subsection (c)(2) encompasses the first two options; subsection (c)(3) contemplates the last. In each instance, the initial financing statement must satisfy Section 9-706(c).

4. Continuation. Subsection (d) refers to the two methods by which a secured party may continue the effectiveness of a pre-effective-date financing statement under this Part. The Comments to Section 9-705 and 9-706 explain these methods.

5. Termination. The effectiveness of a pre-effective-date financing statement may be terminated pursuant to subsection (c). This section also provides an alternative method for accomplishing this result: filing a termination statement in the office in which the financing statement is filed. The alternative method becomes unavailable once an initial financing statement that relates to the pre-effective-date financing statement and satisfies Section 9-706(c) is filed in the jurisdiction and office determined by this Article.

Example 4. The facts are as in Example 1, except that SP wishes to terminate a financing statement filed in State X. As explained in Example 1, the financing statement may be amended in accordance with the law of the jurisdiction governing perfection under this Article, i.e., in accordance with the substantive law of State Y. As enacted in State Y, subsection (c)(1) is inapplicable because the financing statement was not filed in the State Y filing office specified in Section 9-501. Under subsection (c)(2), the financing statement may be amended by filing in the State Y filing office an initial financing statement followed by a termination statement. The filing of an initial financing statement together with a termination statement also would be legally sufficient under subsection (c)(2), but Section 9-512(a)(1) may render this method impractical. The financing statement also may be amended under subsection (c)(3), but the resulting initial financing statement is likely to be very confusing. In each instance, the initial financing statement must satisfy Section 9-706(c). Applying the law of State Y, subsection (e) is inapplicable, because the financing statement was not filed in "this State," i.e., State Y.

This section affords another option to SP. Subsection (b) provides that the effectiveness of a financing statement may be terminated either in accordance with the law of the jurisdiction governing perfection (here, State Y) or in accordance with the substantive law of the jurisdiction in which the financing statement is filed (here, State X). Applying the law of State X, the financing statement is filed in "this State," i.e., State X, and subsection (e) applies. Accordingly, the effectiveness of the financing statement can be terminated by filing a termination statement in the State X office in which the financing statement is filed, unless an initial financing statement that relates to the financing statement and satisfies Section 9-706(c) as enacted in State X has been filed in the jurisdiction and office determined by this Article (here, the State Y filing office).

NORTH CAROLINA COMMENT

Subsection (e) is modified by adding the last sentence. Subsection (f) has no counterpart in the uniform text.

§ 25-9-708. Persons entitled to file initial financing statement or continuation statement.

A person may file an initial financing statement or a continuation statement under this Part if:

(1) The secured party of record authorizes the filing; and

(2) The filing is necessary under this Part:

a. To continue the effectiveness of a financing statement filed before July 1, 2001; or

b. To perfect or continue the perfection of a security interest. (2000-169, s. 1.)

OFFICIAL COMMENT

This section permits a secured party to file an initial financing statement or continuation statement necessary under this part to continue the effectiveness of a financing statement filed before this Article takes effect or to perfect or otherwise continue the perfection of a security interest. Because a filing described in this section typically operates to continue the effectiveness of a financing statement whose filing the debtor already has authorized, this section does not require authorization from the debtor.

§ 25-9-709. Priority.

(a) Law governing priority. — This act determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before July 1, 2001, former Article 9 determines priority.

(b) Priority if security interest becomes enforceable under G.S. 25-9-203. — For purposes of G.S. 25-9-322(a), the priority of a security interest that becomes enforceable under G.S. 25-9-203 dates from July 1, 2001 if the security interest is perfected under this act by the filing of a financing statement before July 1, 2001 which would not have been effective to perfect the security interest under former Article 9. This subsection does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement. (2000-169, s. 1.)

OFFICIAL COMMENT

1. **Law Governing Priority.** Ordinarily, this article determines the priority of conflicting claims to collateral. However, when the relative priorities of the claims were established before July 1, 2001, former article 9 governs.

Example 1: In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. This Article takes effect on July 1, 2001. Thereafter, on August 1, 2001, D creates a security interest in the same account in favor of SP-2, who files a financing statement. This Article determines the relative priorities of the claims. SP-2's security interest has priority under section 9-322(a)(1).

Example 2: In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. In 2000, D creates a security interest in the same account in favor of SP-2, who likewise fails to file a financing statement. This Article takes effect on July 1, 2001. Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 governs priority, and SP-1's security interest has priority under former section 9-312(5)(b).

Example 3: The facts are as in Example 2, except that, on August 1, 2001, SP-2 files a proper financing statement under this article. Until August 1, 2001, the relative priorities of the security interests were established before the effective date of this Article, as in Example 2. However, by taking the affirmative step of filing a financing statement, SP-2 established anew the relative priority of the conflicting claims after the effective date. Thus, this article determines priority. SP-2's security interest has priority under section 9-322(a)(1).

As Example 3 illustrates, relative priorities that are "established" before the effective date do not necessarily remain unchanged following the effective date. Of course, unlike priority contests among unperfected security interests, some priorities are established permanently, e.g., the rights of a buyer of property who took free of a security interest under former article 9.

One consequence of the rule in subsection (a) is that the mere taking effect of this article does not of itself adversely affect the priority of conflicting claims to collateral.

Example 4: In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings (a "general intangible" as defined in former Article 9 but an "account" as defined in this Article). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who files a financing statement covering "accounts and general intangibles." Before this Article takes effect on July 1, 2001, SP-2's perfected security interest has priority over SP-1's unperfected security interest under former section 9-312(5). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Thus, SP-2's priority is not adversely affected by this Article's having taken effect.

Note that were this article to govern priority, SP-2 would become subordinated to SP-1 under section 9-322(a)(1), even though nothing changes other than this article's having taken effect. Under section 9-704, SP-1's security interest would become perfected; the financing statement covering "accounts" adequately covers the lottery winnings and complies with the other perfection requirements of this article, e.g., it is filed in the proper office.

Example 5: In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings—a "general intangible" (as defined under former article 9). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who makes the same mistake and also files a financing statement covering only "accounts." Before this article takes effect on July 1, 2001, SP-1's unperfected security interest has priority over SP-2's unperfected security interest, because SP-1's security interest was the first to attach. See former section 9-312(5)(b). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Although section 9-704 makes both security interests perfected for purposes of this article, both are unperfected under former article 9, which determines their relative priorities.

2. **Financing Statements Ineffective Under Former Article 9 but Effective Under This Article.** If this article determines priority, subsection (b) may apply. It deals with the case in which a filing that occurs before the effective date of this Article would be ineffective to perfect a security interest under former article 9 but effective under this article. For purposes of section 9-322(a), the priority of a security interest that attaches on or after July 1, 2001, and is perfected in this manner dates from the time this Article takes effect.

Example 6: In 1999, SP-1 obtains a security interest in D's existing and after-acquired instruments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired accounts in favor of SP-2, who files a financing statement covering "accounts." After this Article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in section 9-322(a), SP-1 would have priority in the instrument, which constitutes SP-2's proceeds. SP-1's filing in 1999 was earlier than SP-2's in 2000. However, subsection (b) provides that, for purposes of section 9-322(a), SP-1's priority dates from the time this article takes effect (July 1, 2001). Under section 9-322(b), SP-2's priority with respect to the proceeds (instrument) dates from its filing as to the original collateral (accounts). Accordingly, SP-2's security interest would be senior.

Subsection (b) does not apply to conflicting security interests each of which is perfected by a pre-effective-date filing that was not effective under former article 9 but is effective under this article.

Example 7: In 1999, SP-1 obtains a security interest in D's existing and after-acquired instruments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired instruments in favor of SP-2, who files a financing statement covering "instruments." After this article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in section 9-322(a), SP-1 would have priority in the instrument. Both filings are effective under this article, see section 9-705(b), and SP-1's filing in 1999 was earlier than SP-2's in 2000. Subsection (b) does not change this result.

§ 25-9-710. Special transitional provision for maintaining and searching local-filing office records.

(a) In this section:

(1) "Former-Article-9 records" means:

a. Financing statements and other records that have been filed in the local-filing office before July 1, 2001, and that are, or upon processing and indexing will be, reflected in the index maintained, as of June 30, 2001, by the local-filing office for financing statements and other records filed in the local-filing office before July 1, 2001; and

b. The index as of June 30, 2001.

The term does not include records presented to a local-filing office for filing after June 30, 2001, whether or not the records relate to financing statements filed in the local-filing office before July 1, 2001.

(2) "Local-filing office" means a filing office, other than the office of the Secretary of State, that is designated as the proper place to file a financing statement under G.S. 25-9-401(1) of former Article 9. The term applies only with respect to a record that covers a type of collateral as to which the filing office is designated in that section as the proper place to file.

(b) A local-filing office must not accept for filing a record presented after June 30, 2001, whether or not the record relates to a financing statement filed in the local-filing office before July 1, 2001. This subsection does not apply, with respect to financing statements and other records, to a filing office in which mortgages or records of mortgages on real property are required to be filed or recorded, if:

(1) The collateral is timber to be cut or as-extracted collateral; or

(2) The record is or relates to a financing statement filed as a fixture and the collateral is goods that are or are to become fixtures.

(c) Until July 1, 2008, each local-filing office must maintain all former-Article-9 records in accordance with former Article 9. A former-Article-9 record that is not reflected on the index maintained at June 30, 2001, by the local-filing office must be processed and indexed, and reflected on the index as of June 30, 2001, as soon as practicable but in any event no later than July 30, 2001.

(d) Until at least June 30, 2008, each local-filing office must respond to requests for information with respect to former-Article-9 records relating to a debtor and issue certificates, in accordance with former Article 9. The fees charged for responding to requests for information relating to a debtor and issuing certificates with respect to former-Article-9 records must be the fees in effect under former Article 9 on June 30,2001.

(e) After June 30, 2008, each local-filing office may remove and destroy, in accordance with any then applicable record retention law of this State, all former-Article-9 records, including the related index.

(f) Repealed by Session Laws 2001-231, s. 7, effective July 1, 2001. (2000-169, s. 1; 2001-231, s. 7.)

NORTH CAROLINA COMMENT

This section has no counterpart in the uniform text.

TABLES OF COMPARABLE SECTIONS FOR ARTICLE 9

Former to Present

Editor's Note. — The following table shows G.S. sections from former Article 9, as well as several sections from Articles 2 and 2A, and their comparable, new Article 9 numbers. Where there is no comparable, new number, the term "None" has been inserted.

Former Section	Present Section
25-2-326(3)	25-9-102
25-2A-303(3)	25-9-407
25-2A-307(2)(b),(c)	25-9-317
25-2A-307(3)	25-9-321
25-2A-307(4)	25-9-323
25-9-101	25-9-101
25-9-102	25-9-109
25-9-103(1)(a),(b)	25-9-301
25-9-103(1)(c)	None
25-9-103(1)(d)	25-9-316
25-9-103(2)(a),(b)	25-9-303, 25-9-316
25-9-103(2)(c)	None
25-9-103(2)(d)	25-9-337
25-9-103(3)(a),(b)	25-9-301
25-9-103(3)(c)	None
25-9-103(3)(d)	25-9-307
25-9-103(3)(e)	25-9-316
25-9-103(4)	25-9-301
25-9-103(5)	25-9-301
25-9-103(6)	25-9-304, 25-9-305, 25-9-306
25-9-104	25-9-109
25-9-105	25-9-102
25-9-106	25-9-102
25-9-107	25-9-103
25-9-108	None
25-9-109	25-9-102
25-9-110	25-9-108
25-9-111	None
25-9-112	None, see 25-9-102(a)(28)
25-9-113	25-9-110
25-9-114	None, see 325-9-103 and 25-9-324
25-9-115(1)	25-9-102, 25-9-106
25-9-115(2)	25-9-203, 25-9-308
25-9-115(3)	25-9-108
25-9-115(4)	25-9-309, 25-9-312, 25-9-314
25-9-115(5)	25-9-327, 25-9-328, 25-9-329
25-9-115(6)	25-9-203, 25-9-313
25-9-116	25-9-206, 25-9-309
25-9-201	25-9-201
25-9-202	25-9-202
25-203(1) - (3)	25-9-203
25-9-203(4)	25-9-201
25-9-204	25-9-204
25-9-205	25-9-205
25-9-206	25-9-403

Former Section	Present Section
25-9-207	25-9-207
25-9-208	25-9-210
25-9-301(1),(2)	25-9-317
25-9-301(3)	25-9-102
25-9-301(4)	25-9-323
25-9-302(1)	25-9-309, 25-9-310
25-9-302(2)	25-9-310
25-9-302(3),(4)	25-9-311
25-9-302(5)	None, see 25-9-102(a)(40) and (83), 25-9-501, 25-9-502, 25-9-515, 25-7-705
25-9-302(6)	25-9-310
25-9-303	25-9-308
25-9-304	25-9-312
25-9-305	25-9-306, 25-9-313
25-9-306	25-9-315
25-9-307(1),(2)	25-9-320
25-9-307(3)	25-9-323
25-9-308	25-9-330
25-9-309	25-9-331
25-9-310	25-9-333
25-9-311	25-9-401
25-9-312(1)	25-9-322
25-9-312(2)	25-9-102(a)(65),(66), and (67), 25-9-103.1, 25-9-324.1
25-9-312(3),(4)	25-9-324
25-9-312(5),(6)	25-9-322
25-9-312(7)	25-9-323
25-9-313(1) - (7)	25-9-334
25-9-313(8)	25-9-604
25-9-314	25-9-335
25-9-315	25-9-336
25-9-316	25-9-339
25-9-317	25-9-402
25-9-318(1)	25-9-404
25-9-318(2)	25-9-405
25-9-318(3),(4)	25-9-406
25-9-401	25-9-501
25-9-402(1)	25-9-502, 25-9-504
25-9-402(2)	None
25-9-402(3)	25-9-521
25-9-402(4)	25-9-512
25-9-402(5),(6)	25-9-502
25-9-402(7)	25-9-503(a)(4), 25-9-507
25-9-402(8)	25-9-506
25-9-402(9)	None

Former Section	Present Section
25-9-403(1)	25-9-516(a)
25-9-403(2)	25-9-515
25-9-403(3)	25-9-515, 25-9-522
25-9-403(4)	25-9-519
25-9-403(5)	25-9-525
25-9-403(6)	25-9-515
25-9-403(7)	25-9-519
25-9-404	25-9-513
25-9-405	25-9-514, 25-9-519
25-9-406	25-9-512
25-9-407	25-9-523
25-9-408	25-9-505
25-9-501(1),(2)	25-9-601
25-9-501(3)	25-9-602, 25-9-603
25-9-501(4)	25-9-604
25-9-501(5)	25-9-601
25-9-502	25-9-607, 25-9-608
25-9-503	25-9-609
25-9-504(1)	25-9-610, 25-9-615
25-9-504(2)	25-9-615
25-9-504(3)	25-9-610, 25-9-611, 25-9-624
25-9-504(4)	25-9-617
25-9-504(5)	25-9-618
25-9-504.1	None
25-9-504.2	None
25-9-505	25-9-620, 25-9-621, 25-9-624
25-9-506	25-9-623, 25-9-624
25-9-507	25-9-625, 25-9-627
25-9-508	None
25-9-509	None
25-9-601	None
25-9-602	None
25-9-603	None
25-9-604	None
25-9-605	None
25-9-606	None
25-9-607	None

Present to Former

Editor's Note. — The following table shows G.S. sections from new Article 9, and their comparable, former Article 9 numbers, as well as several sections from Articles 2 and 2A. Where there is no comparable, former section number, the term "None" has been inserted.

Former Section	Present Section
25-9-101	25-9-101
25-9-102	25-2-326(3)
25-9-317	25-2A-307(2)(b), (c)
25-9-321	25-2A-307(3)
25-9-102	25-9-105
25-9-102	25-9-106
25-9-102, 25-9-106	25-9-115(1)
25-9-102	25-9-301(3)
25-9-102	25-9-109
25-9-102(a)(65),(66), and (67), 25-9-103.1, 25-9-324.1	25-9-312(2)
25-9-103	25-9-107
25-9-108	25-9-110
25-9-108	25-9-115(3)
25-9-109	25-9-102
25-9-109	25-9-104
25-9-110	25-9-113
25-9-201	25-9-201
25-9-201	25-9-203(4)
25-9-202	25-9-202
25-9-203	25-203(1) - (3)
25-9-203, 25-9-308	25-9-115(2)
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ARTICLE 10.

Effective Date and Repealer.

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§ 25-10-101. Effective date.

This act shall become effective at midnight on June 30, 1967. It applies to transactions entered into and events occurring after that date. (1965, c. 700, s. 11.)

OFFICIAL COMMENT

This effective date is suggested so that there may be ample time for all those who will be affected by the provisions of the Code to become familiar with them.

Legal Periodicals. — For symposium on the UCC in North Carolina, see 44 N.C.L. Rev. 525 (1966).

CASE NOTES

Applied in Yates v. Brown, 275 N.C. 634, 170 S.E.2d 477 (1969); Dunham's Music House, Inc. v. Asheville Theatres, Inc., 10 N.C. App. 242, 178 S.E.2d 124 (1970); Gore v. George J. Ball, Inc., 10 N.C. App. 310, 178 S.E.2d 237 (1971); Hall v. Gurley Milling Co., 347 F. Supp. 13 (E.D.N.C. 1972).

Cited in Redmond v. Lilly, 273 N.C. 446, 160 S.E.2d 287 (1968); Southern Nat'l Bank v. Universal Acceptance Corp., 2 N.C. App. 319, 163 S.E.2d 10 (1968); Baillie Lumber Co. v. Kincaid Carolina Corp., 4 N.C. App. 342, 167 S.E.2d 85 (1969); Gore v. George J. Ball, Inc., 279 N.C. 192, 182 S.E.2d 389 (1971); Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976); Wells v. Barefoot, 55 N.C. App. 562, 286 S.E.2d 625 (1982).

§ 25-10-102. Specific repealer; provision for transition.

(1) The following acts and all other acts and parts of acts inconsistent herewith are hereby repealed:

Uniform Negotiable Instruments Act, G.S. 25-1 through G.S. 25-199.
Uniform Warehouse Receipts Act, G.S. 27-1 through G.S. 27-53.
Uniform Bills of Lading Act, G.S. 21-1 through G.S. 21-41.
Uniform Stock Transfer Act, G.S. 55-75 through G.S. 55-98.
Uniform Trust Receipts Act, G.S. 45-46 through G.S. 45-66.
Agricultural liens for advances, G.S. 44-52 through G.S. 44-64.
Bank collections, G.S. 53-57 and 53-58.
Bulk sales, G.S. 39-23.
Factor's lien acts, G.S. 44-70 through G.S. 44-76.
Assignment of accounts receivable, G.S. 44-77 through G.S. 44-85.

(2) Transactions validly entered into before July 1, 1967, and the rights, duties and interests flowing from them remain valid thereafter and may be terminated, completed, consummated or enforced as required or permitted by any statute or other law amended or repealed by this act as though such repeal or amendment had not occurred. (1965, c. 700, s. 2.)

Editor's Note. — Section 39-23, referred to in the ninth paragraph of subdivision (1), has been repealed.

OFFICIAL COMMENT

Subsection (1) provides for the repeal of present uniform and other acts superseded by this Act. Subsection (2) provides for the transition to the Code.

Legal Periodicals. — For article concerning liens on personal property not governed by the Uniform Commercial Code, see 44 N.C.L. Rev. 322 (1966).

CASE NOTES

Section 20-72 Not Repealed. — It would require a strained interpretation to hold that it was the intention of the General Assembly in adopting the Uniform Commercial Code to repeal the provisions of G.S. 20-72, relating to transfer of title to motor vehicles, without a mention of that section in the specific repealer. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

Cited in Baillie Lumber Co. v. Kincaid Carolina Corp., 4 N.C. App. 342, 167 S.E.2d 85 (1969); Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971); Wells v. Barefoot, 55 N.C. App. 562, 286 S.E.2d 625 (1982).

§ 25-10-103. General repealer.

Except as provided in the following section, all acts and parts of acts inconsistent with this act are hereby repealed. (1965, c. 700, s. 6.)

OFFICIAL COMMENT

This section provides for the repeal of all other legislation inconsistent with this Act.

Editor's Note. — Session Laws 1965, c. 700, s. 6, reads "the following sections 7 and 8" instead of "the following section" as in the 1962 Official Text of the uniform act. Section 7 of c. 700 is codified as G.S. 25-10-104 and § 8 amends G.S. 47-20 and 47-20.2.

CASE NOTES

Motor Vehicles Act Not Repealed. — The legislature did not intend to repeal the Motor Vehicles Act in the general repealer section. Nationwide Mut. Ins. Co. v. Hayes, 276 N.C. 620, 174 S.E.2d 511 (1970).

Cited in Wells v. Barefoot, 55 N.C. App. 562, 286 S.E.2d 625 (1982).

§ 25-10-104: Repealed by Session Laws 2006-112, s. 56, effective October 1, 2006.

Editor's Note. — Session Laws 2006-112, s. 59, provides: "Subparts A and B of Part II of this act apply to a document of title that is issued or a bailment that arises on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a document of title that is issued or a bailment that arises before the effective date of this act even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after the effective date of this act. Subparts A and B of Part II of this act do not apply to a right of action that has accrued before the effective date of this act."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

§ 25-10-105: Repealed by Session Laws 1967, c. 562, s. 3.

§ 25-10-106. Covered transactions not subject to prior registration statutes.

Any security interest subject to article 9 of the Uniform Commercial Code and which is perfected by filing or otherwise under the Uniform Commercial Code, article 9, shall not be subject in any way to chapter 47 of the North Carolina General Statutes. (1965, c. 700, s. 4.)

Editor's Note. — There is no section in the 1962 Official Text of the UCC comparable to this section.

§ 25-10-107: Repealed by Session Laws 1967, c. 562, s. 5.

ARTICLE 11.

1975 Amendatory Act — Effective Date and Transition Provisions.

Editor's Note. — Official Comments in Article 11: Copyright 1962 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

§ 25-11-101. Effective date.

This act shall become effective at 12:01 A.M. on July 1, 1976. (1975, c. 862, s. 8.)

§ 25-11-101.1. Definitions.

(1) As used in this article, "old article 9" means: G.S. 25-1-105, 25-1-201(9), 25-1-201(37), 25-2-107, 25-5-116, and article 9 of chapter 25 of the General Statutes of North Carolina, Uniform Commercial Code, as they are in effect on June 30, 1976, immediately prior to the effective date of this act.

(2) As used in this article, "new article 9" means: G.S. 25-1-105, 25-1-201(9), 25-1-201(37), 25-2-107, 25-5-116, and article 9 of chapter 25 of the General Statutes of North Carolina, Uniform Commercial Code, as said provisions are enacted pursuant to this act, as of July 1, 1976, its effective date. (1975, c. 862, s. 8.)

§ 25-11-102. Preservation of old transition provisions.

The provisions of article 10 of chapter 25 of the General Statutes of North Carolina, Uniform Commercial Code, G.S. 25-10-101 through 25-10-106, thereof shall continue to apply to new article 9, and for this purpose the old article 9 and the new article 9 shall be considered one continuous statute. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

This section may be necessary in states in which the U.C.C. has only recently been effective. It preserves the principle of Section 10-102(2) of the 1962 Code that pre-Code transactions continue to be governed by pre-Code law. A different principle is set forth in this Article 11 for transition problems between the old article 9 and the new article 9, because the changes are not nearly as great. That principle is that the new article 9 governs (with minor exceptions).

§ 25-11-103. Transition to new article 9; general rule.

(1) Transactions validly entered into after midnight on June 30, 1967, and before July 1, 1976, and which were subject to the provisions of old article 9 and which would be subject to this act as amended if they had been entered into after July 1, 1976, and the rights, duties and interests following from such transactions remain valid after the latter date and may be terminated, completed, consummated or enforced as required or permitted by the new article 9.

(2) Security interests arising out of such transactions which are perfected when new article 9 becomes effective shall remain perfected until they lapse as provided in new article 9, and may be continued as permitted by new article 9, except as stated in G.S. 25-11-105. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

This makes the new article 9 applicable to existing security interests, e. g., the revised notice provisions of Part 5 will apply to existing security interests. This would be so even if a 30-day notice period concerning retention of the collateral in lieu of sale were running on the effective date of the new article 9.

Suppose that a security interest attached in State A and the secured party filed in State B and assumed that he had 30 days to have the goods reach State B, in a non-purchase money case, under Section 9-103(3) of the old article 9. Section 9-103(1) (c) of the new article 9 limits the 30-day provision on intended removals to purchase money cases. So long as an ample period of waiting and familiarization is allowed under Section 11-101, this should cause no practical problem.

The "except" clause at the end is necessary because of the possibility that new financing statements would have to be filed in different offices.

§ 25-11-104. Transition provisions on change of requirement of filing.

A security interest for the perfection of which filing or the taking of possession was required under old article 9 and which attached prior to July 1, 1976, but was not perfected shall be deemed perfected on July 1, 1976, if new article 9 permits perfection without filing or authorizes filing in the office or offices where prior ineffective filing was made. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

This covers the case of a purchase money security interest in consumer goods, which would not have had to be filed under the original Code if the goods had not been fixtures. Under the new article 9, the security interest will be perfected without filing, subject to the rights of real estate parties. Section 9-301(1)(d).

This also covers the case of factory or office machinery or replacement consumer goods appliances where the filing of a financing statement under the original Code in the regular chattel files was invalid because the goods were fixtures, but under the new article 9 that filing would be proper.

Under the old article 9 the status of assignments of revenues and similar collateral for governmental obligations was unclear. Section 9-104(e) of the new article 9 will make clear that Article 9 does not apply to these transfers. Section 11-108 of this draft may apply on the theory that the changes made by the new article 9 are considered to be merely declaratory. If this does not dispose of the matter, and if it might sometime be held that an assignment by a municipality had been ineffective for lack of filing, this provision would then apply from the effective date of the new article 9.

§ 25-11-105. Transition provisions on change of place of filing.

(1) A financing statement or continuation statement filed prior to July 1, 1976, which shall not have lapsed prior to July 1, 1976, shall remain effective for the period provided in the old article 9, but not less than five years after the filing.

(2) With respect to any collateral acquired by the debtor subsequent to July 1, 1976, any effective financing statement or continuation statement described in this section shall apply only if the filing or filings are in the office or offices that would be appropriate to perfect the security interests in the new collateral under new article 9.

(3) The effectiveness of any financing statement or continuation statement filed prior to July 1, 1976, may be continued by a continuation statement as permitted by new article 9, except that if new article 9 requires a filing in an office where there was no previous financing statement, a new financing statement conforming to G.S. 25-11-106 shall be filed in that office.

(4) If the record of a mortgage of, or a deed of trust on, real estate would have been effective as a fixture filing of goods described therein if new article 9 had been in effect on the date of recording the mortgage or deed of trust, the mortgage or deed of trust shall be deemed effective as a fixture filing as to such goods under subsection (6) of G.S. 25-9-402 of the new article 9 on July 1, 1976. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

Subsection (1): All existing financing statements with a duration of less than 5 years are extended to the full 5 years. In the case of transmitting utilities for which a special rule of longer validity had been provided, the special rule will be continued.

Subsection (2) makes clear that all existing financing statements and continuations on the effective date remain valid for the remainder of the five years *as to existing collateral,* even though the appropriate place for filing may have changed under the new rules for accounts, general intangibles, etc. The existing filings also apply to new collateral acquired after the effective date, unless the appropriate filing place is different under the new rules. In that case there will have to be a new filing on the effective date to catch new collateral.

Subsection (3): A continuation statement may be filed after the effective date, but if the appropriate places under the new rules are different, the filing should be a financing statement.

Subsection (4) retroactively validates real estate mortgage recording as fixture filing.

§ 25-11-106. Required refilings.

(1) If a security interest is perfected or has priority when this act takes effect as to all persons or as to certain persons without any filing or recording, and if the filing of a financing statement would be required for the perfection or priority of the security interest against those persons under new article 9, the perfection and priority rights of the security interest continue until three years after July 1, 1976. The perfection will then lapse unless a financing statement is filed as provided in subsection (4) or unless the security interest is perfected otherwise than by filing.

(2) If a security interest is perfected when new article 9 takes effect under a law other than chapter 25 of the General Statutes, Uniform Commercial Code, which requires no further filing, refiling or recording to continue its

perfection, perfection continues until and will lapse three years after new article 9 takes effect, unless a financing statement is filed as provided in subsection (4) or unless the security interest is perfected otherwise than by filing, or unless under subsection (3) of G.S. 25-9-302 the other law continues to govern filing.

(3) If a security interest is perfected by a filing, refiling or recording under a law repealed by this act which required further filing, refiling or recording to continue its perfection, perfection continues and will lapse on the date provided by the law so repealed for such further filing, refiling or recording unless a financing statement is filed as provided in subsection (4) or unless the security interest is perfected otherwise than by filing.

(4) A financing statement may be filed within six months before the perfection of a security interest which would otherwise lapse. Any such financing statement may be signed by either the debtor or the secured party. It must identify the security agreement, statement or notice (however denominated in any statute or other law repealed or modified by this act), state the office where and the date when the last filing, refiling or recording, if any, was made with respect thereto, and the filing number, if any, or book and page, if any, of recording and further state that the security agreement, statement or notice, however denominated, in another filing office under chapter 25, Uniform Commercial Code, or under any statute or other law repealed or modified by this act is still effective. G.S. 25-9-401 and 25-9-103 determine the proper place to file such a financing statement. Except as specified in this subsection, the provisions of G.S. 25-9-403(3) for continuation statements apply to such a financing statement. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

Subsection (1) covers farm equipment perfected without filing. The three-year period ought to cover most existing transactions. It also applies to equipment trusts, and would appear to allow three years for filing. But generally filing under Article 9 for equipment trusts is excluded by Section 9-302(3), and the old pre-amendment filing under the Interstate Commerce Act will continue to serve the purpose.

Subsection (2) covers transmitting utility statutes and the like which were *outside the Code,* and provided for indefinite duration. It allows three years for refiling. But perfection under a certificate of title law or the like continues to be effective.

Some states dealt with transmitting utilities by *internal amendment* of the Code to permit filing which was good indefinitely. Section 11-105(1) operates to validate those filings indefinitely even though they may not have been in the Secretary of State's office.

Similarly, Section 11-105(1) would preserve the effect of Ohio's present Section 9-403(2), which in effect makes financing statements related to combined real estate and chattel mortgages good for the duration of the real estate mortgage, whether or not the chattels are fixtures.

Subsection (3) covers the case (if any) where a prior transmitting utility provision outside the Code had a filing of limited duration.

Subsection (4) covers a case where an ordinary continuation statement cannot be filed because the original filing was a non-Code filing or was a Code filing in a different filing office. It was thought advisable to use the concept of financing statement rather than the concept of continuation statement for these fact situations.

§ 25-11-107. Transition provisions as to priorities.

Except as otherwise provided in article 11, old article 9 shall apply to any questions of priority if the positions of the parties were fixed prior to July 1, 1976. In other cases questions of priority shall be determined by new article 9. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

Most questions of priority can be broken down to questions between two parties, and the rule is that the new article 9 applies unless the rights of both parties were fixed under the old article 9.

If a creditor acquires knowledge of an unfiled security interest before the effective date of the new article 9, but gets his judgment after the effective date, the rule of the new article 9 governs, since he has no rights until after judgment and levy.

CASE NOTES

Cited in Provident Fin. Co. v. Beneficial Fin. Co., 36 N.C. App. 401, 245 S.E.2d 510 (1978).

§ 25-11-108. Presumption that rule of law continues unchanged.

Unless a change in law has clearly been made, the provisions of new article 9 shall be deemed declaratory of the meaning of the old article 9. (1975, c. 862, s. 8.)

OFFICIAL COMMENT

This asserts that the new article 9 is declaratory, except where a change is clearly intended. This is an effort to minimize transitional problems.

Chapter 25A.

Retail Installment Sales Act.

Sec.
25A-1. Scope of act.
25A-2. "Consumer credit sale" defined.
25A-3. "Payable in installments" defined.
25A-4. "Goods" defined.
25A-5. "Services" defined.
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25A-8. "Finance charge" defined.
25A-9. "Amount financed" defined.
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25A-11. "Revolving charge account contract" defined.
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25A-13. "Consumer Credit Protection Act" defined.
25A-14. Finance charge rates and service charge for revolving charge account contracts.
25A-15. Finance charge rates for consumer credit installment sale contracts.
25A-16. Transfer of equity.
25A-17. Additional charges for insurance.
25A-18. Confession of judgment.
25A-19. Acceleration.
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Sec.
25A-25. Preservation of consumers' claims and defenses.
25A-26. Substitution of collateral.
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25A-28. Form of consumer credit installment sale contract.
25A-29. Default charges.
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25A-31. Consolidation and refinancing.
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25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.
25A-33. Terms of payments.
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25A-38. "Home-solicitation sale" defined.
25A-39. Buyer's right to cancel.
25A-40. Form of agreement or offer; statement of buyer's rights.
25A-41. Restoration of down payment; retention of goods.
25A-42. Duties as to care and return of goods; no compensation for services prior to cancellation.
25A-43. Unconscionability.
25A-44. Remedies and penalties.
25A-45. Conflict with Consumer Credit Protection Act.

§ 25A-1. Scope of act.

This Chapter applies only to consumer credit sales as hereinafter defined, except that G.S. 25A-37, referral sales, applies to all sales of goods or services as provided therein. This Chapter does not apply to a bona fide direct loan transaction in which a lender makes a direct loan to a borrower, and such lender is not regularly engaged, directly or indirectly, in the sale of goods or the furnishing of services as defined in this Chapter.

Except for G.S. 25A-37, referral sales, those sales defined in G.S. 25A-2(b), and those sales with amounts financed in excess of twenty-five thousand dollars ($25,000) under G.S. 25A-2(a)(5), this Chapter does not apply to any party or transaction that is not also subject to the provisions of the Consumer Credit Protection Act (Federal Truth-in-Lending Act). (1971, c. 796, s. 1; 1983, c. 686, s. 1; 2005-338, s. 1.)

Editor's Note. — This section, as amended by Session Laws 2005-338, s. 1, effective October 1, 2005, is applicable to sales that occur on or after that date.

Legal Periodicals. — For article discussing the scope of this Chapter and its impact on the agreement and performance stages of a consumer credit transaction, see 50 N.C.L. Rev. 767 (1972).

For survey of 1977 commercial law, see 56 N.C.L. Rev. 915 (1978).

For comment discussing usury limitations in North Carolina, in light of Western Auto Supply Co. v. Vick, 303 N.C. 30, 277 S.E.2d 360, aff'd on rehearing, 304 N.C. 191, 283 S.E.2d 101 (1981), see 18 Wake Forest L. Rev. 947 (1982).

CASE NOTES

Lender Not Engaged in Sale of Goods And Services. — Plaintiff borrowers' contention that bank was "indirectly" engaged in the furnishing of goods and services when it provided loan for a mobile home was supported by neither logic nor the plain language of this section. Collins v. Horizon Hous., Inc., 135 N.C. App. 227, 519 S.E.2d 534 (1999).

Class Actions Allowed. — When the General Assembly has wished to prevent class actions to enforce statutory claims for relief, where the relief sought was personal and penal in nature, it has said so expressly and unequivocally. The failure of the General Assembly to expressly prohibit class actions to enforce this statute convinces the Supreme Court that it intended to allow them for such purposes. Crow v. Citicorp Acceptance Co., 319 N.C. 274, 354 S.E.2d 459 (1987).

The court upheld the certification of a class comprising of Chapter 7 debtors whose cases were pending in the bankruptcy courts of the Eastern and Middle Districts of North Carolina on the date of certification who had a Sears revolving charge account governed by this Act that included a balance, as of each debtor's petition date, which represented the credit purchases of at least two items of personal property on which Sears retained security interests. Coggin v. Sears, Roebuck & Co., 155 Bankr. 934 (Bankr. E.D.N.C. 1993).

Pro Rata Application of Payments to Consolidated Purchases Allowed. — The North Carolina Retail Installment Sales Act provides a method for applying payments to consolidated purchases on a pro rata basis. In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

Applied in Simmons v. C.W. Myers Trading Post, Inc., 56 N.C. App. 549, 290 S.E.2d 710 (1982).

Cited in State ex rel. Edmisten v. J.C. Penney Co., 292 N.C. 311, 233 S.E.2d 895 (1977); Addison v. Britt, 83 N.C. App. 418, 350 S.E.2d 158 (1986); Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-2. "Consumer credit sale" defined.

(a) Except as provided in subsection (c) of this section, a "consumer credit sale" is a sale of goods or services in which

(1) The seller is one who in the ordinary course of business regularly extends or arranges for the extension of consumer credit, or offers to extend or arrange for the extension of such credit,

(2) The buyer is a natural person,

(3) The goods or services are purchased primarily for a personal, family, household or agricultural purpose,

(4) Either the debt representing the price of the goods or services is payable in installments or a finance charge is imposed, and

(5) The amount financed does not exceed seventy-five thousand dollars ($75,000) or, in the case of a debt secured by real property or a manufactured home as defined in G.S. 143-145(7), regardless of the amount financed.

(b) "Sale" includes but is not limited to any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods and services involved, and it is agreed that the bailee or lessee will become, or for no other or for a nominal consideration, has the option to become, the owner of the goods and services upon full compliance with his obligations under such contract.

The term also includes a contract in the form of a terminable bailment or lease of goods or services in which the bailee or lessee can renew the bailment or lease contract periodically by making the payment or payments specified in the contract if:

(1) The contract obligates the bailor or lessor to transfer ownership of the property to the bailee or lessee for no other or a nominal consideration (no more than ten percent (10%) of the cash price of the property at the time the bailor or lessor initially enters into the contract with the bailee or lessee) upon the making of a specified number of payments by the bailee or lessee; and

(2) The dollar total of the specified number of payments necessary to exercise the purchase option is more than ten percent (10%) in excess of the aggregate value of the property and services involved. For the purposes of this subsection, the value of goods shall be the average cash retail value of the goods. The value of services shall be the average retail value, if any, of such services, as determined by substantial cash sales of such services. If a contract is found to be a sale under this subsection, these values shall be used to determine the amount financed for purposes of G.S. 25A-15.

(c) A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by someone other than a seller that is engaged in part or entirely in the business of selling goods or services or similar arrangement is not a consumer credit sale. A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by the seller, a subsidiary or a parent corporation of the seller, a principal supplier of the seller or any corporation having shareholders in common with the seller holding over twenty-five percent (25%) of the voting stock in each corporation is a consumer credit sale within the terms of this Chapter.

(d) For the purposes of this Chapter, a consumer credit sale shall be deemed to have been made in this State, and therefore subject to the provisions of this Chapter, if the seller offers or agrees in this State to sell to a buyer who is a resident of this State, or if such buyer accepts or makes the offer in this State to buy, regardless of the situs of the contract as specified therein.

Any solicitation or communication to sell, oral or written, originating outside of this State, but forwarded to and received in this State by a buyer who is a resident of this State, shall be deemed to be an offer or agreement to sell in this State.

Any solicitation or communication to buy, oral or written, originating within this State, from a buyer who is a resident of this State, but forwarded to and received by a retail seller outside of this State, shall be deemed to be an acceptance or offer to buy in this State.

(e) If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above states the amount of any payment, the advertisement must also clearly and conspicuously state the following items, as applicable:

(1) A statement that the transaction advertised is a lease;

(2) The total amount of periodic payments necessary to acquire ownership or a statement that the consumer has the option to purchase the property and at what time;

(3) That the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above refers to the right to acquire ownership, the advertisement must clearly and conspicuously state whether or not the consumer may terminate the lease at any time without penalty and that the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

No one shall advertise in connection with any terminable bailment or lease defined as a sale in subsection (b) above the ownership option as a means of deceiving any lessee into believing that he is purchasing the item of personal property. (1971, c. 796, s. 1; 1979, c. 706, s. 1; 1981, c. 970, s. 2; 1983, c. 686, ss. 2, 3; 1987, c. 282, s. 5; 1991, c. 602, s. 1; 2005-338, s. 2.)

Editor's Note. — The increase from $25,000 to $75,000 in subdivision (a)(5), as amended by Session Laws 2005-338, s. 1, effective October 1, 2005, is applicable to sales that occur on or after that date.

Legal Periodicals. — For survey of 1982 commercial law, see 61 N.C.L. Rev. 1018 (1983).

CASE NOTES

Transaction Held Not Consumer Credit Sale. — A transaction whereby the seller would forbear collection of an amount due from the buyer on an open-end credit plan and reduce interest rates, and the buyer would execute a promissory note to the seller and give the seller a deed of trust on a farm to secure the note was not a "consumer credit sale" within the meaning of this section, but rather constituted a novation of the old agreement. Anderson v. Pamlico Chem. Co., 470 F. Supp. 12 (E.D.N.C. 1977).

Applied in Commercial Credit Equip. Corp. v. Thompson, 48 N.C. App. 594, 269 S.E.2d 286 (1980); In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

Cited in GECC v. Ball, 40 N.C. App. 586, 253 S.E.2d 574 (1979); Simmons v. C.W. Myers Trading Post, Inc., 68 N.C. App. 511, 315 S.E.2d 75 (1984).

§ 25A-3. "Payable in installments" defined.

A debt is "payable in installments" when the buyer is required or permitted by agreement to make payment in more than four installments, excluding a down payment, and whether or not a finance charge is imposed by the seller. (1971, c. 796, s. 1.)

§ 25A-4. "Goods" defined.

(a) "Goods" means all things which are moveable at the time of the sale or at the time the buyer takes possession, including goods not in existence at the time the transaction is entered into and goods which are furnished or used at the time of sale or subsequently in modernization, rehabilitation, repair, alteration, improvement or construction on real property so as to become a part thereof whether or not they are severable therefrom. "Goods" also includes merchandise certificates.

(b) "Merchandise certificate" means a writing issued by a seller not redeemable in cash and usable in its face amount in lieu of cash in exchange for goods and services. (1971, c. 796, s. 1.)

§ 25A-5. "Services" defined.

(a) "Services" includes:
  (1) Work, labor, and other personal services; and
  (2) Privileges with respect to transportation, hotel and restaurant accommodations, education, entertainment, recreation, physical culture, hospital accommodations, funerals and other similar services.

(b) "Services" does not include:
  (1) Services for which the cost is by law fixed or approved by or filed with or subject to approval or disapproval by the United States or the State of North Carolina or any agency, instrumentality or subdivision thereof;
  (2) Insurance premiums financing covered by G.S. 58-35-1 to 58-35-95 and G.S. 58-3-145; or

(3) Insurance provided by an insurer that is licensed to do business in this State. (1971, c. 796, s. 1.)

CASE NOTES

Applied in Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-6. "Seller" defined.

"Seller" means one regularly engaged in the business of selling goods or services. Unless otherwise provided, "seller" also means and includes an assignee of the seller's right to payment but use of the term does not itself impose on an assignee any obligation of the seller with respect to events occurring before the assignment. (1971, c. 796, s. 1.)

§ 25A-7. "Cash price" defined.

"Cash price" of goods and services means the price at which the goods or services are offered for sale by the seller to cash buyers in the ordinary course of business and may include:

(1) Applicable sales, use, and excise and documentary stamp taxes; and

(2) The cash price of accessories or related services such as installation, delivery, servicing, repairs or alterations. (1971, c. 796, s. 1.)

CASE NOTES

Applied in In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

§ 25A-8. "Finance charge" defined.

(a) "Finance charge" means the sum of all charges payable directly or indirectly by the buyer and imposed by the seller as an incident to the extension of credit, including any of the following types of charges which are applicable:

(1) Interest, time price differential, service, carrying or other similar charge however denominated;

(2) Premium or other charges for any guarantee or insurance protecting the seller against the buyer's default or other credit loss;

(3) Loan fee, finder's fee or similar charge; and

(4) Fee for an appraisal, investigation or credit report.

(b) Finance charge does not include transfer of equity fees, substitution of collateral fees, default or deferment charges, or additional charges for insurance as permitted by G.S. 25A-17 or charges for insurance excluded by Section 226.4(a) of Regulation Z promulgated pursuant to section 105 of the Consumer Credit Protection Act.

(c) With respect to a transaction in which the seller acquires a security interest in real property, finance charge does not include charges excluded by section 226.4(e) of Regulation Z promulgated pursuant to section 105 of the Consumer Credit Protection Act. (1971, c. 796, s. 1.)

§ 25A-9. "Amount financed" defined.

(a) "Amount financed" means the total of the following to the extent that payment is deferred by the seller:

(1) The cash price of the goods or services less the amount of any down payment whether made in cash or property traded in,
(2) The amount actually paid or to be paid by the seller pursuant to an agreement with the buyer to discharge a security interest or lien on property traded in,
(3) Additional charges for insurance described in G.S. 25A-8(b) and charges referred to in G.S. 25A-8(c), and
(4) Official fees as described in G.S. 25A-10, to the extent they are itemized and disclosed to the buyer.

(b) If not included in the cash price, the amount financed includes any applicable sales, use or documentary stamp taxes and any amount actually paid or to be paid by the seller for registration, certificate of title or license fees. (1971, c. 796, s. 1.)

§ 25A-10. "Official fees" defined.

"Official fees" means:
(1) Fees and charges prescribed by law which actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest related to a consumer credit sale; or
(2) Premiums payable for insurance in lieu of perfecting a security interest otherwise required by the seller in connection with a consumer credit sale if the premium does not exceed the fees or charges described in subdivision (1) of this section which would otherwise be payable. (1971, c. 796, s. 1.)

§ 25A-11. "Revolving charge account contract" defined.

"Revolving charge account contract" means an agreement or understanding between a seller and a buyer under which consumer credit sales may be made from time to time, under the terms of which a finance charge or service charge is to be computed in relation to the buyer's unpaid balance from time to time, and under which the buyer has the privilege of paying the balance in full or in installments. This definition shall not affect the meaning of the term "revolving charge account" appearing in G.S. 24-11(a). (1971, c. 796, s. 1.)

CASE NOTES

Cited in State Whsle. Supply, Inc. v. Allen, 30 N.C. App. 272, 227 S.E.2d 120 (1976).

§ 25A-12. "Consumer credit installment sale contract" defined.

"Consumer credit installment sale contract" means the agreement between a buyer and a seller in a consumer credit sale other than a sale made pursuant to a revolving charge account. (1971, c. 796, s. 1.)

§ 25A-13. "Consumer Credit Protection Act" defined.

"Consumer Credit Protection Act" means the Consumer Credit Protection Act, an act of Congress of May 29, 1968, as amended (Public Law 90-321; 82 Stat. 146; 15 U.S.C. 1601 et seq.), and regulations and rulings promulgated thereunder. (1971, c. 796, s. 1.)

§ 25A-14. Finance charge rates and service charge for revolving charge account contracts.

(a) The finance-charge rate and either the annual charge or the monthly service charge for a consumer credit sale made under a revolving charge account contract may not exceed the rates and charge provided for revolving credit by G.S. 24-11.

(b) In the event the revolving charge account contract is secured in whole or in part by a security interest in real property, then the finance-charge rate shall not exceed the rate set out in G.S. 25A-15(d).

(c) No default or deferral charge shall be imposed by the seller in connection with a revolving charge-account contract, except as specifically provided for in G.S. 24-11(d1). (1971, c. 796, s. 1; 1983, c. 126, s. 7; 1991, c. 506, s. 7.)

§ 25A-15. Finance charge rates for consumer credit installment sale contracts.

(a) With respect to a consumer credit installment sale contract, a seller may contract for and receive a finance charge not exceeding that permitted by this section. For the purposes of this section, the finance charge rates are the rates that are required to be disclosed by the Consumer Credit Protection Act.

(b) Except as hereinafter provided, the finance charge rate for a consumer credit installment sales contract may not exceed:

(1) Twenty-four percent (24%) per annum where the amount financed is less than one thousand five hundred dollars ($1,500);
(2) Twenty-two percent (22%) per annum where the amount financed is one thousand five hundred dollars ($1,500) or greater, but less than two thousand dollars ($2,000);
(3) Twenty percent (20%) where the amount financed is two thousand ($2,000) or greater, but less than three thousand dollars ($3,000);
(4) Eighteen percent (18%) per annum where the amount financed is three thousand dollars ($3,000) or greater,

except that a minimum finance charge of five dollars ($5.00) may be imposed.

(c) A finance charge rate not to exceed the higher of the rate established in subsection (b) or the rate set forth below may be imposed in a consumer credit installment sale contract repayable in not less than six installments for a self-propelled motor vehicle:

(1) Eighteen percent (18%) per annum for vehicles one and two model years old;
(2) Twenty percent (20%) per annum for vehicles three model years old;
(3) Twenty-two percent (22%) per annum for vehicles four model years old; and
(4) Twenty-nine percent (29%) per annum for vehicles five model years old and older.

A motor vehicle is one model year old on January 1 of the year following the designated year model of the vehicle.

(d) Notwithstanding the provisions of subsections (b) and (c), above, in the event that the amount financed in a consumer credit sale contract is secured in whole or in part by a security interest in real property, the finance charge rate may not exceed sixteen percent (16%) per annum.

(e) A seller may not divide a single credit sale transaction into two or more sales to avoid the limitations as to maximum finance charges imposed by this section.

(f) Notwithstanding the provisions of subsections (b) or (d), the parties to a consumer credit installment sale contract for the sale of a residential manufactured home which is secured by a first lien on that home or on the land on which such home is located may contract in writing for the payment of a finance charge as agreed upon by the parties. Provided, this subsection shall only apply if the parties would have been entitled to so contract by the provisions of section 501 of United States Public Law 96-221, and have complied with the regulations promulgated thereto.

For the purposes of this subsection (f), a "residential manufactured home" means a mobile home as defined in G.S. 143-145(7) which is used as a dwelling. (1971, c. 796, s. 1; 1979, 2nd Sess., c. 1330, ss. 1, 2; 1981, c. 446, ss. 1-3; 1983, c. 126, s. 2.)

Legal Periodicals. — For article calling for a comprehensive federal consumer credit code, see 58 N.C.L. Rev. 1 (1979).

For comment discussing usury limitations in North Carolina, in light of Western Auto Supply Co. v. Vick, 303 N.C. 30, 277 S.E.2d 360, aff'd on rehearing, 304 N.C. 191, 283 S.E.2d 101 (1981), see 18 Wake Forest L. Rev. 947 (1982).

For note, "Civil Procedure — A Definition of 'Class' Under North Carolina Rule 23 — Crow v. Citicorp Acceptance Co.," see 23 Wake Forest L. Rev. 491 (1988).

CASE NOTES

Subsection (d) Not Applicable to Novation. — Where the transaction in question was not a "consumer credit sale" under this Chapter but a novation, the restrictions of subsection (d) of this section would not be applicable. Anderson v. Pamlico Chem. Co., 470 F. Supp. 12 (E.D.N.C. 1977).

§ 25A-16. Transfer of equity.

If a buyer voluntarily transfers his rights in collateral pursuant to applicable law and the seller agrees, the seller may impose a transfer fee not to exceed ten percent (10%) of the unpaid balance of the debt or thirty-five dollars ($35.00), whichever is less. (1971, c. 796, s. 1; 2000-169, s. 31.)

§ 25A-17. Additional charges for insurance.

(a) As to revolving charge account contracts defined in G.S. 25A-11, in addition to the finance charges permitted in G.S. 24-11(a), a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, against loss of or damage to property securing the debt pursuant to G.S. 25A-23, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the insurer through which the insurance is obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly disclosed to the buyer, and any buyer desiring such insurance coverage gives affirmative indication of such desire after disclosure of the cost of such insurance.

(b) As to revolving charge account contracts defined in G.S. 25A-11, insurance that is required by a seller and is not an additional charge permitted by subsection (a) of this section, shall be included in the finance charge as computed according to G.S. 24-11(a).

(c) As to consumer credit installment sale contracts defined in G.S. 25A-12, in addition to the finance charges permitted in G.S. 25A-15, a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, for loss of or damage to property or against liability arising out of the ownership or use of property, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the person through which the insurance is to be obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly and conspicuously disclosed in writing to the buyer; and any buyer desiring such insurance coverage gives specific dated and separately signed affirmative written indication of such desire after receiving written disclosure to him of the cost of such insurance. (1971, c. 796, s. 1; 1993, c. 226, s. 15.)

§ 25A-18. Confession of judgment.

A buyer may not authorize any person to confess judgment on a claim arising out of a consumer credit sale. An authorization in violation of this section is void. (1971, c. 796, s. 1.)

CASE NOTES

Cited in Burton v. Blanton, 107 N.C. App. 615, 421 S.E.2d 381 (1992).

§ 25A-19. Acceleration.

With respect to a consumer credit sale, the agreement may not provide for repossession of any goods or acceleration of the time when any part or all of the time balance becomes payable other than for breach by the buyer of any promise or condition clearly set forth in the agreement. (1971, c. 796, s. 1.)

§ 25A-20. Disclaimer of warranty.

With respect to any consumer credit sale, the agreement may not contain any provision limiting, excluding, modifying or in any manner altering the terms of any express warranty given by any seller (excluding assignees) to any buyer and made a part of the basis of the bargain between the original parties. (1971, c. 796, s. 1.)

CASE NOTES

Applied in Simmons v. C.W. Myers Trading Post, Inc., 307 N.C. 122, 296 S.E.2d 294 (1982).

Cited in Simmons v. C.W. Myers Trading Post, Inc., 68 N.C. App. 511, 315 S.E.2d 75 (1984).

§ 25A-21. Attorneys' fees.

With respect to a consumer credit sale:

(1) In the event that the seller institutes a suit and prevails in the litigation and obtains a money judgment, the presiding judge shall allow a reasonable attorney's fee to the duly licensed attorney representing the seller in such suit, said attorney's fee to be taxed to the buyer as part of the court costs.

(2) In the event that a seller instituting suit does not prevail in the litigation, the presiding judge shall allow a reasonable attorney's fee to the duly licensed attorney representing the buyer in such suit, said

attorney's fee to be taxed to the seller as a part of the court costs. (1971, c. 796, s. 1.)

§ 25A-22. Receipts for payments; return of title documents upon full payment.

(a) When any payment is made under any consumer credit sale transaction, the person receiving such payment shall, if the payment is made in cash, give the buyer a written receipt therefor. If the buyer specifies that the payment is made on one of several obligations, the receipt shall so state.

(b) Upon the payment of all sums for which the buyer is obligated under a consumer credit sale, the seller shall promptly release any security interest in accordance with the terms of G.S. 25-9-513 or G.S. 20-58.4, whichever is applicable. In the event a security interest in real property is involved, the seller shall take such action as is necessary to enable the lien to be discharged of record under the provisions of G.S. 45-37. (1971, c. 796, s. 1; 2000-169, s. 32.)

§ 25A-23. Collateral taken by the seller.

(a) The seller in a consumer credit sale may take a security interest only in the following property of the buyer to secure the debt arising from the sale:

(1) The property sold,

(2) Property previously sold by the seller to the buyer and in which the seller has an existing security interest,

(3) Personal property to which the property sold is installed, if the amount financed is more than three hundred dollars ($300.00),

(4) Real property to which the property sold is affixed, if the amount financed is more than one thousand dollars ($1,000), and

(5) A self-propelled motor vehicle to which repairs are made, if the amount financed exceeds one hundred dollars ($100.00).

(6) Any property which is used for agricultural purposes, if the property sold is to be used in the operation of an agricultural business.

(b) A security interest taken in property other than that permitted in subsection (a) of this section shall be void and not enforceable.

(c) Nothing in this section shall affect any right or liens granted by Chapter 44A of the General Statutes.

(d) The provisions of G.S. 24-11(a), limiting the taking of a security interest in property under an open end credit or similar plan, shall not apply to revolving charge account contracts regulated by this Chapter; provided, however, the application of payments rule set out in G.S. 25A-27 shall apply to such contracts; provided further, that in any action initiated by the seller for the possession of such property, a judgment for the possession thereof shall be restricted to commercial units (as defined in G.S. 25-2-105(6)) for which the cash price was one hundred dollars ($100.00) or more. (1971, c. 796, s. 1; 1977, c. 508; c. 789, s. 1.)

CASE NOTES

Cited in Anderson v. Pamlico Chem. Co., 470 F. Supp. 12 (E.D.N.C. 1977); Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-24. Identification of instruments of indebtedness.

With respect to consumer credit sales, each instrument of indebtedness shall be identified on the face of the instrument as a consumer credit document, or otherwise clearly indicate on its face that it arises out of a consumer credit sale, provided, that such designation of an instrument of indebtedness regarding as sale which is not by definition a "consumer credit sale," shall not solely because of such designation cause the transaction to be a consumer credit sale. (1971, c. 796, s. 1.)

§ 25A-25. Preservation of consumers' claims and defenses.

(a) In a consumer credit sale, a buyer may assert against the seller, assignee of the seller, or other holder of the instrument or instruments of indebtedness, any claims or defenses available against the original seller, and the buyer may not waive the right to assert these claims or defenses in connection with a consumer credit sales transaction. Affirmative recovery by the buyer on a claim asserted against an assignee of the seller or other holder of the instrument of indebtedness shall not exceed amounts paid by the buyer under the contract.

(b) Every consumer credit sale contract shall contain the following provision in at least ten-point boldface type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

(c) Compliance with the requirements of the Federal Trade Commission rule on preservation of consumer claims and defenses is considered full compliance with this act. (1971, c. 796, s. 1; 1977, c. 921.)

CASE NOTES

Applied in GECC v. Ball, 40 N.C. App. 586, 253 S.E.2d 574 (1979); Commercial Credit Equip. Corp. v. Thompson, 48 N.C. App. 594, 269 S.E.2d 286 (1980); State ex rel. Easley v. Rich Food Servs., Inc., 139 N.C. App. 691, 535 S.E.2d 84, 2000 N.C. App. LEXIS 1041 (2000).

Cited in ITT-Industrial Credit Co. v. Milo Concrete Co., 31 N.C. App. 450, 229 S.E.2d 814 (1976).

§ 25A-26. Substitution of collateral.

Subject to the provisions of G.S. 25A-23, if all involved parties agree, there may be a substitution of collateral under a security instrument in a consumer credit sale. For such substitution, the seller may impose a fee not to exceed ten percent (10%) of the unpaid balance of the debt or fifteen dollars ($15.00), whichever is less. (1971, c. 796, s. 1.)

§ 25A-27. Application of payments.

(a) Where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest pursuant to G.S. 25A-23 in goods previously purchased by the buyer from the seller, the seller shall make application of payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments made prior to such subsequent purchase shall be deemed to have been applied to the previous purchases, and

(2) Unless otherwise designated by the buyer, the amount of down payment on such subsequent purchase shall be applied to the subsequent purchase, and

(3) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(b) Where a seller and a buyer agree to consolidate two or more consumer credit installment sale contracts pursuant to G.S. 25A-31, the seller shall apply payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments received prior to the consolidation shall be applied to the respective contracts under which the payments were made, and

(2) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(c) For payments received by a seller on or after October 1, 1988, but before October 1, 1993, a seller may elect to apply the provisions of this section as the section read October 1, 1993, or as the section read September 30, 1993. A seller made this election when the seller determined, and disclosed to the buyer, how payments received on a consumer credit sale would be applied: either on a proportional basis or on a “first in - first out” basis with the payments applied first to finance charges and then to principal in the order that each obligation is assumed.

(d) The exclusive remedy for failure of a seller to apply payments of a buyer as required by subdivision (a)(3) or (b)(2) of this section during the period October 1, 1993, through October 1, 1996, is an order that the seller apply the payments as required by those provisions. (1971, c. 796, s. 1; 1993, c. 370, s. 2; 1993 (Reg. Sess., 1994), c. 745, s. 38.3(a).)

CASE NOTES

Editor's Note. *— The cases below were decided under this section prior to the 1993 amendment of subdivisions (a)(3) and (b)(2), which formerly provided for proportional application of payments.*

This section was drafted for the protection of both merchant and consumer, not just the merchant. Dossenbach's of Clinton, Inc. v. Bartelt (In re Beasley), 23 Bankr. 404 (Bankr. E.D.N.C. 1982).

And clearly places the burden of apportionment of payments upon the seller. If the creditor-seller wishes to avail itself of the benefits of this statute, the creditor-seller must apportion the debtor-purchaser's payments when they are made and not wait for litigation to ensue. It would even seem appropriate for the retail installment contract or purchase-money instrument to provide for the apportionment of payments as specified in the statute so that the debtor-purchaser would be fully informed of the fact that the creditor-seller intends to exercise its rights under this statute in the event of default. Otherwise, the merchants might be inclined to assert a security interest in an item of property to the full extent of the total debt even though there was only a lesser sum owed on the balance of the purchase price of that item of property. Dossenbach's of Clinton, Inc. v. Bartelt (In re Beasley), 23 Bankr. 404 (Bankr. E.D.N.C. 1982).

The apportionment requirements of this section inherently recognize the continuing purchase money nature of installment sale contracts which are consolidated in that payments must be applied to the various contracts in the same proportion or ratio as the original cash prices in the various contracts bear to one another. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

Payments Must Be Applied as Stated in Subsection (b). — As G.S. 25A-31(b) reveals, the only statutory requirement governing the terms of refinancing or consolidation agreements is that the agreements must be in writing, dated, and signed by the parties. However, upon consolidation of two or more installment sale contracts, the seller must apply payments as set out in subsection (b) of this section. The purpose of such application is to permit a determination of the amount of the debt secured by each of the various security agreements. A similar application is required where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest in goods previously purchased by the buyer from the seller. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

In the event a dispute arises concerning application of payments, the statutory guidelines established by this section must be followed. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

Compliance Required. — Revolving chart account requiring that finance charges for newly purchased goods be satisfied before payments would be applied to previously purchased items expanded the existing security interest in prior purchases to secure not only their own purchase price but also the payment of finance charges on items bought later was an agreement that created a security interest in previously purchased property, and thereby required compliance with the apportionment provisions of this section. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Cited in In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

§ 25A-28. Form of consumer credit installment sale contract.

Every consumer credit installment sale contract shall be in writing, dated and signed by the buyer. (1971, c. 796, s. 1.)

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

CASE NOTES

Cited in Varnell v. Henry M. Milgrom, Inc., 78 N.C. App. 451, 337 S.E.2d 616 (1985).

§ 25A-29. Default charges.

If any installment is past due for 10 days or more according to the original terms of the consumer credit installment sale contract, a default charge may be made in an amount not to exceed five percent (5%) of the installment past due or six dollars ($6.00), whichever is the lesser. A default charge may be imposed only one time for each default.

If a default charge is deducted from a payment made on the contract and such deduction results in a subsequent default on a subsequent payment, no default charge may be imposed for such default.

If a default charge has been once imposed with respect to a particular default in payment, no default charge shall be imposed with respect to any future payments which would not have been in default except for the previous default.

A default charge for any particular default shall be deemed to have been waived by the seller unless, within 45 days following the default, (i) the charge is collected or (ii) written notice of the charge is sent to the buyer. (1971, c. 796, s. 1.)

CASE NOTES

Applied in Steed v. First Union Nat'l Bank, 58 N.C. App. 189, 293 S.E.2d 217 (1982).

§ 25A-30. Deferral charges.

(a) A seller may, by agreement with the buyer, defer the due date of all or any part of one or more installments under an existing consumer credit installment sale contract.

(b) Except as provided by subsections (e) and (f) of this section, a deferral agreement must be in writing, dated and signed by the parties.

(c) A deferral agreement may provide for a deferral charge not to exceed the rate of one and one-half percent (11/2%) of each installment for each month from the date which such installment or part thereof would otherwise have been payable to the date when such installment or part thereof is made payable under the deferral agreement.

(d) If a deferral charge is made pursuant to a deferral agreement, a default charge provided in G.S. 25A-29 may be imposed only if the installment as deferred is not paid when due and no new deferral agreement is entered into with respect to that installment.

(e) If the deferral agreement extends the due date of only one installment, the agreement need not be in writing.

(f) A deferral agreement for which no charge is made shall not be subject to subsections (b), (c) or (d) of this section. (1971, c. 796, s. 1.)

§ 25A-31. Consolidation and refinancing.

(a) A seller and a buyer may agree at any time to refinance an existing consumer credit installment sale contract or to consolidate into a single debt repayable on a single schedule of payments, two or more consumer credit installment sale contracts.

(b) A refinancing or consolidation agreement must be in writing, dated and signed by the parties.

(c) The refinancing or consolidation agreement may provide for a finance charge which shall not exceed the rates provided in G.S. 25A-15, with the amount financed being the unpaid time balance of the contract or contracts refinanced or consolidated, less the rebate provided by G.S. 25A-32. In computing the rebate to be credited to the previous time balances for purposes of this section, no prepayment charge shall be imposed. (1971, c. 796, s. 1.)

CASE NOTES

This section recognizes the right of a seller and buyer to consolidate one consumer credit installment sale contract with another. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

However, a seller's willingness to consolidate or refinance may be affected by recent bankruptcy decisions. Several bankruptcy courts have held that the purchase money status of a consumer credit installment sale may be lost when refinanced or consolidated with loans or other indebtedness. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

Subsection (b) does not require that the consolidation or refinancing agreement provide for apportionment in its written terms. The purchase money character of agreements which are refinanced or consolidated is not destroyed by failure to provide for apportionment. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

Payments Must Be Applied as Stated in § 25A-27(b). — As subsection (b) of this section reveals, the only statutory requirement governing the terms of refinancing or consolidation agreements is that the agreements must be in writing, dated, and signed by the parties. However, upon consolidation of two or more installment sale contracts, the seller must apply payments as set out in G.S. 25A-27(b). The purpose of such application is to permit a determination of the amount of the debt secured by each of the various security agreements. A similar application is required where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest in goods previously purchased by the buyer from the seller. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

Section 25A-27 Controls in Case of Dispute. — In the event a dispute arises concerning application of payments, the statutory guidelines established by G.S. 25A-27 must be followed. Schewel Furn. Co. v. Goard, 26 Bankr. 316 (Bankr. M.D.N.C. 1982).

§ 25A-32. Rebates on prepayment.

Notwithstanding any provision in a consumer credit installment sale contract to the contrary, any buyer may satisfy the debt in full at any time before maturity, and in so satisfying such debt, shall receive a rebate, the amount of which shall be computed under the “rule of 78’s,” as follows:

“The amount of such rebate shall represent as great a proportion of the finance charge (less a prepayment charge of ten percent (10%) of the unpaid balance, not to exceed twenty-five dollars ($25.00)) as the sum of the periodical time balances after the date of prepayment in full bears to the sum of all the periodical time balances under the schedule of payments in the original contract.” No rebate is required if the amount thereof is less than one dollar ($1.00).

If the prepayment is made otherwise than on the due date of an installment, it shall be deemed to have been made on the installment due date nearest in time to the actual date of payment.

If a seller obtains a judgment on a debt arising out of a consumer credit installment sale or the seller repossesses the collateral securing the debt, the seller shall credit the buyer with a rebate as if the payment in full had been made on the date the judgment was obtained or 15 days after the repossession occurred. If the seller obtains a judgment and repossesses the collateral, the seller shall credit the buyer with a rebate as if payment in full had been made on the date of the judgment or 15 days after the repossession, whichever occurs earlier. (1971, c. 796, s. 1.)

§ 25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.

(a) Notwithstanding any statutory or contractual provision to the contrary, in a consumer credit installment sale contract with an amount financed of five thousand dollars ($5000.00) or more secured by real estate or by a residential manufactured home as defined in G.S. 143-145(7), any buyer may satisfy the debt in full at any time before maturity, and in so satisfying the debt, shall be credited with all unearned finance charges as computed on the simple interest or actuarial method.

(b) If a seller obtains a judgment on a debt arising out of a consumer credit installment sale described in subsection (a) of this section, or if the seller forecloses or repossesses the collateral securing the debt, the seller shall credit the buyer with all unearned finance charges as computed on the simple interest or actuarial method as if the payment in full had been made on the date the judgment was obtained or 15 days after the foreclosure or repossession occurred, whichever is earlier. If the seller obtains a judgment and repossesses the collateral, the seller shall credit the buyer with all unearned finance charges as if payment in full had been made on the date of the judgment or 15 days after the repossession, whichever occurs earlier. (1991, c. 602, s. 2.)

§ 25A-33. Terms of payments.

A consumer credit installment sale contract shall provide for complete payment of all charges due under the contract, including the amount financed, the finance charge, and additional insurance charges, if any, within a period from the time of the sale of

(1) Forty-two months, if the amount financed is less than one thousand five hundred dollars ($1,500), or

(2) Sixty-four months, if the amount financed is one thousand five hundred dollars ($1,500) or greater, but less than two thousand five hundred dollars ($2,500), or

(3) One hundred and twenty-two months, if the amount financed is two thousand five hundred dollars ($2,500) or greater, but less than five thousand dollars ($5,000), or

(4) One hundred and eighty-two months, if the amount financed is five thousand dollars ($5,000) or greater, but less than ten thousand dollars ($10,000), or

(5) As the contract provides, if the amount financed is ten thousand dollars ($10,000) or greater.

The provisions of this section shall not apply to a consumer credit installment sale contract executed in connection with any financing which is insured under regulations of the Federal Housing Administration or the Veterans Administration. (1971, c. 796, s. 1; 1973, c. 1446, s. 3.)

CASE NOTES

Cited in Richardson v. Bank of Am., N.A., — N.C. App. —, 643 S.E.2d 410, 2007 N.C. App. LEXIS 809 (2007).

§ 25A-34. Balloon payments.

With respect to a consumer credit sale, other than one pursuant to a revolving charge account, no scheduled payment may be more than ten percent (10%) (except the final payment may be twenty-five percent (25%)) larger than the average of earlier scheduled payments. This provision does not apply when the payment schedule is adjusted to the seasonal or irregular income of the buyer. (1971, c. 796, s. 1.)

§ 25A-35. Statement of account.

(a) One time during each 12-month period following execution of a consumer credit installment sale contract and when the buyer repays the debt early, the buyer shall be entitled upon request and without charge to a statement of account from the seller. The statement of account shall contain the following information identified as such in the statement:

(1) The itemized amounts paid by or on behalf of the buyer to the date of the statement of account, except that upon early termination of the contract by prepayment or otherwise, the statement shall include itemized charges for expenses of repossession, storage and legal expenses;

(2) The itemized amounts, if any, which have become due but remain unpaid, including any charges for defaults, expenses of repossession and deferral charges;

(3) The number of installment payments and the dollar amount of each installment not due but still to be paid and the remaining period the contract is to run.

(b) The buyer may request and shall be entitled to additional statements of account but for such additional statements the seller may impose a charge of one dollar ($1.00).

(c) If the buyer requests information for income tax purposes as to the amount of the finance charges, the seller shall provide such information within 30 days without charge but only once in each calendar year. (1971, c. 796, s. 1.)

§ 25A-36. Certificates of insurance and rebates.

(a) Within 45 days following the purchase of insurance by the buyer from or through the seller, the seller shall deliver, send or cause to be sent to the buyer a policy or policies of such insurance or a certificate or certificates thereof. If such insurance is cancelled, or the premium adjusted, any rebate received by the seller shall be promptly applied to the purchase of other similar insurance, credited to the buyer's account, or rebated to the buyer. Unless otherwise required by law or the provisions of the policy, rebates of cancelled insurance shall be computed under the rule of 78's, without the deduction of a prepayment charge.

(b) In those cases where the insurance premium is added in the contract, and the buyer did not actually pay the premium, the return premium plus unearned finance charge on the amount of returned premium (at the same rate as used in the contract) shall be credited to the unpaid balance of the contract. If the required insurance premium is adjusted upward by the insurance company or is added in accordance with the contract, the buyer, after 10 days' notice,

(1) May pay the additional premium, or

(2) Have the additional premium plus finance charge (at the same rate as used in the contract) added to the unpaid balance and spread equally over the remaining installments unpaid, provided, the seller may require a buyer who wishes to finance such additional premium to be financed by the seller in accordance with North Carolina insurance regulations. (1971, c. 796, s. 1; 1977, c. 650.)

§ 25A-37. Referral sales.

The advertisement for sale or the actual sale of any goods or services (whether or not a consumer credit sale) at a price or with a rebate or payment or other consideration to the purchaser that is contingent upon the procurement of prospective customers provided by the purchaser, or the procurement of sales to persons suggested by the purchaser, is declared to be unlawful. Any obligation of a buyer arising under such a sale shall be void and a nullity and a buyer shall be entitled to recover from the seller any consideration paid to the seller upon tender to the seller of any tangible consumer goods made the basis of the sale. (1971, c. 796, s. 1.)

CASE NOTES

Referral Sale. — In essence, a referral sale is a transaction in which a person is induced to purchase goods or services upon the representation that the purchaser can reduce or recover the purchase price or earn a commission by referring other prospective buyers to the seller for similar purchases. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Referral Sales Condemned. — In recognition of the vast potential for deception and exploitation of the public inherent in referral sales and in furtherance of the vital state interest in protecting citizens from fraud, our legislature, by enacting this section, has condemned all referral sales contracts, declaring them both unlawful and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Fact that contingency in referral contract related to price of renewal rather than original membership was of little significance, since in either circumstance the promise of something for nothing would serve as the incentive to make a purchase. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Where spa represented to purchaser, in effect, that if she purchased an initial membership, she could then obtain an additional year or years of membership free by referring an adequate number of prospects to the spa, this transaction clearly constituted a sale of services with other consideration to the purchaser that is contingent upon the procurement of prospective customers provided by the purchaser. Thus, the contract between purchaser and the spa constituted a referral sale, in violation of this section, and was void and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Cited in State ex rel. Morgan v. Dare to Be Great, Inc., 15 N.C. App. 275, 189 S.E.2d 802 (1972).

§ 25A-38. "Home-solicitation sale" defined.

"Home-solicitation sale" means a consumer credit sale of goods or services in which the seller or a person acting for him engages in a personal solicitation of the sale at a residence of the buyer and the buyer's agreement or offer to purchase is there given to the seller or a person acting for him. It does not include

(1) A sale made to a buyer who has previously engaged in a similar business transaction with the seller;
(2) A sale made pursuant to a preexisting revolving charge account;
(3) A sale made pursuant to negotiations between the parties on the premises of a business establishment at a fixed location where such goods or services are offered or exhibited for sale;
(4) A sale which is regulated by the provisions of Section 226.9 of Regulation Z promulgated pursuant to Section 105 of the Consumer Credit Protection Act; or
(5) Sales of personal wearing apparel, motor vehicles defined in G.S. 20-286(10), farm equipment and goods and services to be utilized within 10 days in connection with funeral services. (1971, c. 796, s. 1; 1973, c. 672.)

§ 25A-39. Buyer's right to cancel.

(a) Except as provided in subsection (e) of this section, in addition to any right otherwise to revoke an offer, the buyer has the right to cancel a home-solicitation sale until midnight of the third business day after the day on which the buyer signs an agreement or offer to purchase which complies with G.S. 25A-40, or which complies with the requirements of the Federal Trade Commission Trade Regulation Rule Concerning a Cooling-Off Period for Door-to-Door Sales.

(b) Cancellation occurs when the buyer gives written notice of cancellation to the seller at the address stated in the agreement or offer to purchase.

(c) Notice of cancellation, if given by mail, is given when it is deposited in the United States mail properly addressed and postage prepaid.

(d) Unless the seller complies with G.S. 25A-40(b), notice of cancellation given by the buyer need not take a particular form and is sufficient if it indicates by any form of written expression the intention of the buyer not to be bound by the home-solicitation sale.

(e) The buyer may not cancel a home-solicitation sale if the buyer requests the seller in a separate writing to provide goods or services without delay because of an urgency or an emergency, and

(1) The seller in good faith makes a substantial beginning of performance of the contract before the buyer gives notification of cancellation,

(2) In the case of goods, the goods cannot be returned to the seller in substantially as good condition as when received by the buyer, and

(3) Unless the buyer returns the goods, if any, to the seller at his expense.

(f) A buyer, who has not received delivery of the goods and services from the seller in a home-solicitation sale within 30 days following the execution of the contract (and such delay is the fault of the seller), shall have the right at any time thereafter before acceptance of the goods and services to rescind the contract and to receive a refund of all payments made and to a return of all goods traded in to the seller on account of or in contemplation of such contract, or if the goods traded in cannot or are not returned to the buyer within 10 days after cancellation, the buyer may elect to recover an amount equal to the trade-in allowance stated in the contract. By written agreement, the buyer may agree to a later time for the delivery of goods and services. (1971, c. 796, s. 1; 1975, c. 805, s. 1.)

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

CASE NOTES

Unfair and Deceptive Act. — Failure to comply with a Federal Trade Commission regulation, 16 C.F.R. G.S. 429.1(e), by failing to orally explain to purchasers their rights to cancel at the time the agreement was signed, coupled with defective notice of cancellation, which was incomplete and unattached to the contract in violation of G.S. 25A-40(b) and 16 C.F.R. G.S. 429.1(b), constituted an unfair and deceptive act in violation of G.S. 75-1.1. Eastern Roofing & Aluminum Co. v. Brock, 70 N.C. App. 431, 320 S.E.2d 22 (1984).

§ 25A-40. Form of agreement or offer; statement of buyer's rights.

(a) In a home-solicitation sale the seller must present to the buyer and obtain his signature to a fully completed written agreement or offer to purchase which is in the same language as that principally used in the oral sales presentation and which designates as the date of the transaction the date on which the buyer actually signs and which contains the name and address of the seller, and which contains in immediate proximity to the space reserved for the signature of the buyer in bold face type of a minimum size of 10 points, a statement in substantially the following form:

> "You, the buyer, may cancel this transaction at any time prior to midnight of the third business day after the date of this transaction. See the attached Notice of Cancellation form for an explanation of this right."

(b) The seller must, in addition to furnishing the buyer with a copy of the contract or offer to purchase, furnish to the buyer at the time he signs the home-solicitation sale contract or otherwise agrees to buy consumer goods or services from the seller, a completed form in duplicate, captioned "Notice of Cancellation," which shall be attached to the contract and easily detachable, and which shall contain in 10 point bold face type the following information and statements in the same language as that used in the contract:

"Notice of Cancellation

(enter date of transaction)

____

(date)

You may cancel this transaction, without any penalty or obligation, within three business days from the above date.

If you cancel, any property traded in, and payments made by you under the contract or sale, and any negotiable instrument executed by you will be returned within 10 business days following receipt by the seller of your cancellation notice, and any security interest arising out of the transaction will be canceled.

If you cancel, you must make available to the seller at your residence, in substantially as good condition as when received, any goods delivered to you under this contract or sale; or you may, if you wish, comply with the instructions of the seller regarding the return shipment of the goods at the seller's expense and risk.

If you do make the goods available to the seller and the seller does not pick them up within 20 days of the date of your notice of cancellation, you may retain or dispose of the goods without any further obligation. If you fail to make the goods available to the seller, or if you agree to return the goods to the seller and fail to do so, then you remain liable for performance of all obligations under the contract.

To cancel this transaction, mail or deliver a signed and dated copy of this cancellation notice or any other written notice, or send a telegram to ______________________________,

(name of seller)

at ______________________________,

(address of seller's place of business)

not later than midnight of ______________________________.

(date)

I hereby cancel this transaction.

____

(date)

____

(Buyer's Signature)"

(1971, c. 796, s. 1; 1975, c. 805, s. 2.)

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

CASE NOTES

Unfair and Deceptive Act. — Failure to comply with a Federal Trade Commission regulation, 16 C.F.R. G.S. 429.1(e), by failing to orally explain to purchasers their rights to cancel at the time the agreement was signed, coupled with defective notice of cancellation, which was incomplete and unattached to the contract in violation of G.S. 25A-40(b) and 16 C.F.R. G.S. 429.1(b), constituted an unfair and deceptive act in violation of G.S. 75-1.1. Eastern Roofing & Aluminum Co. v. Brock, 70 N.C. App. 431, 320 S.E.2d 22 (1984).

§ 25A-41. Restoration of down payment; retention of goods.

(a) Except as provided in this section, within 10 business days after a home-solicitation sale has been canceled or an offer to purchase revoked in accordance with G.S. 25A-40, the seller must tender to the buyer any payments made by the buyer and any note or other evidence of indebtedness.

(b) If the down payment includes goods traded in, the goods must be tendered at the buyer's residence in substantially as good condition as when received by the seller. If the seller fails to tender the goods as provided by this section, the buyer may elect to recover an amount equal to the trade-in allowance stated in the agreement.

(c) Repealed by Session Laws 1975, c. 805, s. 3.

(d) Until the seller has complied with the obligations imposed by this section, the buyer may retain possession of goods delivered to him by the seller and has a lien on the goods in his possession or control for any recovery to which he is entitled. (1971, c. 796, s. 1; 1975, c. 805, s. 3.)

§ 25A-42. Duties as to care and return of goods; no compensation for services prior to cancellation.

(a) Except as provided by the provisions on retention of goods by the buyer (G.S. 25A-41(d)), within a reasonable time after a home-solicitation sale has been canceled, the buyer must make available to the seller at the buyer's residence in substantially as good condition as received, any goods delivered under the contract or sale, or in the alternative, the buyer may comply with the instructions of the seller regarding the return shipment of the goods at the seller's expense and risk. The seller shall within 10 business days of receipt of the buyer's notice of cancellation notify the buyer whether the seller intends to repossess or to abandon any shipped or delivered goods. If the buyer makes the goods available to the seller and the seller does not pick them up within 20 days of the date of the notice of cancellation, the buyer may retain or dispose of the goods without any further obligation. If the buyer fails to make the goods available to the seller, or agrees to return the goods to the seller and fails to do so, then the buyer shall remain liable for performance of all obligations under the contract.

(b) The buyer has the duty of a bailee to take reasonable care of the goods in his possession before cancellation or revocation and for a reasonable time thereafter, during which time the goods are otherwise at the seller's risk.

(c) If the seller has performed any services pursuant to a home-solicitation sale prior to its cancellation, the seller is entitled to no compensation therefor.

(d) The seller shall not negotiate, transfer, sell, or assign any note, contract, or other evidence of indebtedness arising out of a home-solicitation sale to a finance company or other third party prior to midnight of the fifth business day following the day the contract was signed or the goods or services were purchased. (1971, c. 796, s. 1; 1975, c. 805, s. 4.)

§ 25A-43. Unconscionability.

(a) With respect to a consumer credit sale, if the court finds the agreement or any clause of the agreement to have been unconscionable at the time it was made, the court may refuse to enforce the agreement, or it may enforce the remainder of the agreement without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) If it is claimed or appears to the court that the agreement or any clause thereof may be unconscionable, all parties shall be afforded a reasonable opportunity to present evidence as to its setting, purpose and effect to aid the court in making its determination.

(c) As used in this section, "unconscionable" shall mean totally unreasonable under all of the circumstances. (1971, c. 796, s. 1.)

CASE NOTES

Cited in Billings v. Joseph Harris Co., 27 N.C. App. 689, 220 S.E.2d 361 (1975); Brenner v. Little Red Sch. House, Ltd., 302 N.C. 207, 274 S.E.2d 206 (1981); Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-44. Remedies and penalties.

In addition to remedies hereinbefore provided, the following remedies shall apply to consumer credit sales:

(1) In the event that a consumer credit sale contract requires the payment of a finance charge not more than two times in excess of that permitted by this Chapter, the seller or an assignee of the seller shall not be permitted to recover any finance charge under that contract and, in addition, the seller shall be liable to the buyer in an amount that is two times the amount of any finance charge that has been received by the seller, plus reasonable attorney's fees incurred by the buyer as determined by the court. However, if the requirement of an excess charge results from an accidental or good faith error, the seller shall be liable only for the amount by which the finance charge exceeds the rates permitted by this Chapter.

(2) In the event that a consumer credit sale contract requires the payment of a finance charge more than two times that permitted by this Chapter, the contract shall be void. The buyer may, at his option, retain without any liability any goods delivered under such a contract and the seller or an assignee of the rights shall not be entitled to recover anything under such contract.

(3) In the event the seller or an assignee of the seller (i) shall fail to make any rebate required by G.S. 25A-32 or G.S. 25A-36, (ii) shall charge and receive fees or charges in excess of those specifically authorized by this Chapter, or (iii) shall charge and receive sums not authorized by this Chapter, the buyer shall be entitled to demand and receive the rebate due and excessive or unauthorized charges. Ten days after receiving written request therefor, the seller shall be liable to the buyer for an amount equal to three times the sum of any rebate due and all improper charges which have not been rebated or refunded within the 10-day period.

(4) The knowing and willful violation of any provision of this Chapter shall constitute an unfair trade practice under G.S. 75-1.1.

(5) Any buyer injured by any violation of G.S. 25A-2(e) may bring an action for recovery of damages, including reasonable attorney's fees. (1971, c. 796, s. 1; 1983, c. 686, s. 4.)

CASE NOTES

Availability of Remedies. — In order to create a security interest in previously purchased property, the seller must provide for apportioning payments in the charge account contract. The failure to do so means that no security interest comes into existence and the remedies for a violation of this Act contained in this section do not apply. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Applied in Simmons v. C.W. Myers Trading Post, Inc., 307 N.C. 122, 296 S.E.2d 294 (1982); Steed v. First Union Nat'l Bank, 58 N.C. App. 189, 293 S.E.2d 217 (1982).

Cited in State ex rel. Morgan v. Dare to Be Great, Inc., 15 N.C. App. 275, 189 S.E.2d 802 (1972); Anderson v. Pamlico Chem. Co., 470 F. Supp. 12 (E.D.N.C. 1977); Marshall v. Miller, 47 N.C. App. 530, 268 S.E.2d 97 (1980); Simmons v. C.W. Myers Trading Post, Inc., 68 N.C. App. 511, 315 S.E.2d 75 (1984).

§ 25A-45. Conflict with Consumer Credit Protection Act.

In all cases of irreconcilable conflict between the provisions of this Chapter and the provisions of the Consumer Credit Protection Act, the provisions of the Consumer Credit Protection Act shall control. (1971, c. 796, s. 3.)

CASE NOTES

Cited in State ex rel. Edmisten v. J.C. Penney Co., 292 N.C. 311, 233 S.E.2d 895 (1977).

Chapter 25B.

Credit.

Article 1.

Credit Rights of Women.

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25B-2. Responsibility of credit-reporting agency to maintain separate credit histories.

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ARTICLE 1.

Credit Rights of Women.

§ 25B-1. Equal availability of credit for women.

(a) No married woman shall be denied credit in her own name if her uncommingled earnings, separate property or other assets are such that a man possessing the same amount of uncommingled earnings, separate property or other assets would receive credit.

(b) No unmarried woman shall be denied credit in her own name if her property, earnings or other assets are such that a man possessing the same amount of property, earnings or other assets would receive credit.

(c) For the purposes of this section, "credit" means the obtaining of money, property, labor or services on a deferred-payment basis. (1973, c. 1394, s. 1.)

§ 25B-2. Responsibility of credit-reporting agency to maintain separate credit histories.

A credit-reporting agency shall, upon written request of a married person, identify within any report delivered by the agency, both the separate credit history of each spouse and the credit history of their joint accounts, if such information is on file with the credit-reporting agency. (1973, c. 1394, s. 2.)

§ 25B-3. Right of action to enforce Article.

(a) A married or unmarried woman denied credit in violation of this Chapter shall have a right of action on account of such violation in which she shall be entitled to actual damages, and reasonable attorney's fees in the discretion of the court to be taxed as part of the cost.

(b) Violations of this Chapter may be enjoined by action of the Attorney General brought in behalf of the State pursuant to authority granted in G.S. 114-2. (1973, c. 1394, s. 3.)

§ 25B-4. Granting of credit not otherwise affected.

Nothing contained herein shall be construed to deprive any credit grantor of his right to deny credit or limit its terms based upon its evaluation of the applicant's capability or willingness to repay, or to require any credit grantor to give preferential treatment to any applicant because of sex or marital status. (1973, c. 1394, s. 4.)

Chapter 25C.

Sales of Artwork.

Article 1.

Artwork on Consignment.

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Article 1.

Artwork on Consignment.

§ 25C-1. Definitions.

As used in this Article unless the context clearly requires otherwise:

(1) "Art dealer" means an individual, partnership, firm, association, or corporation that undertakes to sell a work of fine art created by someone else;
(2) "Artist" means the creator of a work of fine art;
(3) "On consignment" means delivered to an art dealer for the purpose of sale or exhibition, or both, to the public by the art dealer; and
(4) "Work of fine art" means an original art work that is:
  a. A visual rendition, including a painting, drawing, sculpture, mosaic, or photograph;
  b. A work of calligraphy;
  c. A work of graphic art, including an etching, lithograph, offset print, or silk screen;
  d. A craft work in materials, including clay, textile, fiber, wood, metal, plastic, or glass; or
  e. A work in mixed media, including a collage or a work consisting of any combination of works included in this subdivision. (1983, c. 822, s. 1; 1989, c. 464, s. 1.)

§ 25C-2. Interest of art dealer who accepts works of fine art on consignment.

If an art dealer accepts a work of fine art on a fee, commission, or other compensation basis on consignment from the artist:

(1) The art dealer is, with respect to that work of fine art, the bailee of the artist;
(2) The work of fine art is bailment property in which the art dealer has no legal or equitable interest until the work is sold to a bona fide third party; and
(3) The proceeds of the sale of the work of fine art are bailment property in which the art dealer has no legal or equitable interest until the amount due the artist from the sale, minus the agreed commission, is paid. (1983, c. 822, s. 1.)

§ 25C-3. Status of works of fine art subsequently purchased by art dealer for his own account.

Notwithstanding the subsequent purchase of a work of fine art by the art dealer directly or indirectly for the art dealer's own account, a work of fine art that is bailment property when initially accepted by the art dealer remains bailment property until the purchase price minus the agreed upon commission, is paid in full to the artist. (1983, c. 822, s. 1.)

§ 25C-4. Creditors of art dealer may not reach works of fine art on consignment with art dealer.

Property that is bailment property under this Article is not subject to the claims, liens, or security interests of the creditors of an art dealer. (1983, c. 822, s. 1; 1989, c. 464, s. 1.)

§ 25C-5. Risk of loss; insurable interest.

Nothing in this Article shall affect any provision of law pertaining to the risk of loss between or among the parties to a consignment agreement under this Article or pertaining to the insurable interest of any such party. (1983, c. 822, s. 1; 1989, c. 464, s. 1.)

§§ 25C-6 through 25C-9: Reserved for future codification purposes.

Article 2.

Sale of Prints.

§ 25C-10. Definitions.

As used in this Article, the term:

- (1) "Artist" means any person who created or who conceived of and approved:
  - a. The master image of a work of art for a print, including but not limited to a photograph or a negative; or
  - b. The master image of a work of art which served as the model for a print.
- (2) "Art dealer" means a person:
  - a. Who is in the business of dealing in prints to which this Article applies; or
  - b. Who holds himself out as having knowledge or skills particular to prints to which this Article applies; or
  - c. Who employs an agent or other intermediary who holds himself out as having knowledge or skills particular to prints to which this Article applies; or
  - d. Who is a professional auctioneer who sells prints to which this Article applies, at auctions.
- (3) "Fine print" means a printed image on paper or any other suitable substance which is based on an artist's master image and has been taken off a plate by printing, stamping, casting, or any other process commonly used in the graphic arts, and includes but is not limited to engraving, etching, woodcut, lithograph, or serigraph, or a print developed or created from a negative when such negative is itself an original work of art.

(4) "Person" means an individual, partnership, corporation, association, joint venture, or any other legal or commercial entity.

(5) "Plate" means a plate, stone, block, or other material used to create a fine print or from which a fine print is taken.

(6) "Print" means a fine print or reproduction as defined in this Article.

(7) "Photograph" means the image produced upon a photosensitive surface by the chemical action of light.

(8) "Negative" means any negative image, photographic plate, slide, or other material created by the artist and used for the purpose of creating the print.

(9) "Reproduction" means a copy of a fine print or other work of art made by a commercial mechanical process which does not require the use of an original plate or an original negative.

(10) "Signed print" means a finished fine print autographed by the artist and not by mechanical means of reproduction, whether or not it was signed or unsigned in the plate.

(11) "Work of art" means an original art work that is:
  a. A visual rendition, including a painting, drawing, sculpture, mosaic, or photograph;
  b. A work of calligraphy;
  c. A work of graphic art, including but not limited to a fine print;
  d. A craft work in materials, including clay, textile, fiber, wood, metal, plastic, or glass; or
  e. A work in mixed media, including a collage or a work consisting of any combination of works included in this subdivision. (1989, c. 464, s. 1; 1997-456, s. 27.)

Cross References. — As to applicability of this Article, see G.S. 25C-16.

Editor's Note. — The subdivisions of this section were renumbered pursuant to Session Laws 1997-456, s. 27, which authorized the Revisor of Statutes to renumber or reletter sections and parts of sections having a number or letter designation that is incompatible with the General Assembly's computer database.

§ 25C-11. General prohibitions.

(a) An art dealer may not publish in or distribute in, into or from, this State any catalog, prospectus, circular, advertisement or other publication which solicits a direct sale, by inviting transmittal of payment for a specific print not exempt under G.S. 25C-16, unless it clearly sets forth, in close physical proximity to the place in such publication describing the print, all information required by G.S. 25C-14. This requirement does not apply to general written material or advertising that does not solicit such a direct sale.

(b) An art dealer may not sell or invite offers to buy any print not exempt under G.S. 25C-16, either at retail or wholesale, unless the art dealer clearly and conspicuously discloses in writing to prospective purchasers, all information required by G.S. 25C-14. At public or private auction, an art dealer may not invite offers to buy any non-exempt print unless the art dealer clearly and conspicuously discloses in writing such required information to prospective bidders before any offer is made and until an offer is accepted. (1989, c. 464, s. 1.)

§ 25C-12. Sale by artist; consignments.

(a) The disclosure requirements of this Article do not apply to a sale of a print by the artist who produced the print, directly to a purchaser, without the intervention of a wholesale or retail merchant, unless the artist is an art dealer within the definition of G.S. 25C-10(2)a. or unless the artist consigns a print of his own creation.

(b) An artist or art dealer who consigns a print to an art dealer for the purpose of effecting a sale of such print shall have no liability to a purchaser under this Article if such consignor, as to the consignee, has complied with the disclosure requirements of this Article. (1989, c. 464, s. 1.)

§ 25C-13. Warranties.

(a) Whenever an art dealer discloses information as required by G.S. 25C-11, such information shall be a part of the basis of the bargain and shall create express warranties as to the information so provided.

(b) When information is not disclosed as required by G.S. 25C-11, such nondisclosure shall constitute an express warranty that such information is not required to be disclosed.

(c) Evidence of a warranty made in accordance with this Article shall be prima facie evidence of reliance upon the warranty. (1989, c. 464, s. 1.)

§ 25C-14. Disclosure requirements.

(a) An art dealer who sells or offers to sell a print not exempt under G.S. 25C-16, shall disclose the following information in a writing to the prospective purchaser:

(1) The name of the artist;
(2) The year the plate or negative was created;
(3) The year when the print was printed or created;
(4) The process used to create the master image;
(5) The process used to create the print;
(6) Whether the print is part of a limited edition.

(b) If the print or its plate or negative is a mechanical, photomechanical or photographic copy or reproduction of a master image previously created or produced in another medium, this information shall be disclosed as part of the disclosure required by subsection (a) of this section.

(c) If the print is represented to be part of a limited edition, the disclosure required by subsections (a) and (b) of this section shall further state:

(1) The authorized maximum number of numbered or signed prints, or both, in the edition;
(2) The authorized maximum number of unnumbered or unsigned prints, or both, in the edition;
(3) Any authorized maximum number of artist's, publisher's, printer's, or other proofs, exclusive of trial proofs, outside the regular edition;
(4) The total number of prints, either numbered or unnumbered, in the edition;
(5) Whether the plate or negative has been destroyed, effaced, altered, defaced, or cancelled after the current edition;
(6) If there were any prior plates or negatives of the same master image, the total number of plates or negatives and a designation of the plate or negative from which the print was taken;
(7) If there were any prior or later editions from the same plate or negative, the series number of the edition of which the print is a part, and the aggregate size of all other editions;
(8) Whether the print was published as a book illustration or in a magazine article;
(9) Whether the edition is a posthumous edition or a restrike, and, if it is, whether the plate has been reworked;
(10) The name of any workshop where the edition was printed; and

(11) Whether the print has been printed on acid-free paper.

(d) Whenever an art dealer disclaims knowledge as to a particular item about which information is required, such disclaimer shall be clearly and conspicuously stated in unqualified terms as to each of those items of information required by this section and shall be contained in writing in the physical context of other language setting forth the required information to be disclosed under this section. (1989, c. 464, s. 1.)

§ 25C-15. Rights and liabilities not inclusive.

(a) An art dealer who sells a print in violation of this Article shall be liable to the purchaser of the print; the purchaser shall be entitled to recover of the art dealer the consideration paid by the purchaser for the print, with interest at the legal rate thereon, upon the tender of the print in substantially the same condition in which it was received by the purchaser.

(b) If an art dealer liable to a purchaser under the provisions of subsection (a) of this section wrongfully refuses to repay the purchaser's consideration as specified therein, the purchaser who prevails in a civil action to recover such consideration may also recover all expenses incurred in connection with the action, including a reasonable attorney's fee.

(c) A willful violation of this Article shall constitute a prima facie violation of G.S. 75-1.1.

(d) The rights and liabilities created by this Article shall be construed to be in addition to and not in substitution, exclusion, or displacement of other rights and liabilities provided by law. (1989, c. 464, s. 1.)

§ 25C-16. Exemptions.

(a) This Article shall not apply to any print when offered for sale or sold at wholesale or retail for one hundred dollars ($100.00) or less, exclusive of the value of any frame.

(b) This Article shall not apply to any print described clearly and conspicuously in writing by the seller as a "reproduction and not a fine print", unless the print is said or represented to be one in a limited edition, an edition of numbered or signed prints, or any combination thereof.

(c) This Article shall not apply to the sale of any print sold before January 1, 1990. (1989, c. 464, s. 1.)

Chapter 26.

Suretyship.

Sec.
26-1. Surety and principal distinguished in judgment and execution.
26-2. Principal liable on execution before surety.
26-3. Summary remedy of surety against principal.
26-3.1. Surety's recovery on obligation paid; no assignment necessary.
26-4. Subrogation of surety paying debt of deceased principal.
26-5. Contribution among sureties.

Sec.
26-6. Dissenting surety not liable to surety on stay of execution.
26-7. Surety, indorser, or guarantor may notify creditor to take action.
26-8. Notice; how given; prima facie evidence thereof.
26-9. Effect of failure of creditor to take action.
26-10. [Repealed.]
26-11. Cancellation of judgment as to surety.
26-12. Joinder of debtor by surety.

§ 26-1. Surety and principal distinguished in judgment and execution.

In the trial of actions upon contracts either of the defendants may show in evidence that he is surety, and if it be satisfactorily shown, the jury in their verdict, or the magistrate in his judgment, shall distinguish the principal and surety, which shall be endorsed on the execution by the clerk of superior court. (1826, c. 31, s. 1; R.C., c. 31, s. 124; Code, s. 2100; Rev., s. 2840; C.S., s. 3961; 1973, c. 108, s. 14.)

Cross References. — As to right of surety to subrogation, see note to G.S. 26-3.

CASE NOTES

A guaranty of payment is an absolute promise by the guarantor to pay a debt at maturity if it is not paid by the principal debtor. This obligation is independent of the obligation of the principal debtor, and the creditor's cause of action against the guarantor ripens immediately upon the failure of the principal debtor to pay the debt at maturity. Exxon Chem. Ams. v. Kennedy, 59 N.C. App. 90, 295 S.E.2d 770 (1982).

A surety is bound with his principal as an original promisor. Coleman v. Fuller, 105 N.C. 328, 11 S.E. 175 (1890).

And Must Pay Debt When Principal Fails to Do So. — The surety's promise is to pay a debt, which becomes his own debt when the principal fails to pay it. Coleman v. Fuller, 105 N.C. 328, 11 S.E. 175 (1890).

The liability of a surety cannot be enlarged by construction. George D. Witt Shoe Co. v. Peacock, 150 N.C. 545, 64 S.E. 437 (1909).

Liability of Principal and Surety Limited to Terms of Contract. — The principal and his surety are liable under a contract expressed in definite terms and their liability cannot be carried beyond the fair meaning of those terms. State ex rel. Duckett v. Pettee, 50 N.C. App. 119, 273 S.E.2d 317 (1980).

Obligation of Surety on Corporate Debt Is Measured by Obligation of Corporation. — While a surety's liability is primary, its liability for a corporate debt is not indistinguishable from that of the corporation. The obligation of the surety is ordinarily measured by the obligation of the corporation, and a surety has usually been held to his or her contract, except where the entire agreement is unenforceable. Colonial Acceptance Corp. v. Northeastern Printcrafters, Inc., 75 N.C. App. 177, 330 S.E.2d 76 (1985).

Order of Liability. — The order in which parties to a security are liable at law is the order in which, independently of contract, they will be held bound in equity. Smith v. Smith, 16 N.C. 173 (1828).

Where it appeared that a negotiable instrument was signed by three persons other than the principal obligor, and it also appeared from a writing executed some time thereafter by one to indemnify the other two that they (the other two) "signed as co-sureties" of the third, it was held that the character of suretyship in which all three signed was sufficiently established. Southerland v. Fremont, 107 N.C. 565, 12 S.E. 237 (1890).

Same — Parol Evidence to Show Coprincipals. — In Williams v. Glenn, 92 N.C. 253 (1885), the note (under seal) was made with W. "as principal" and B. and G. "as sureties, " yet as between the obligors the court held that parol evidence was admissible to show that Boyden and Glenn were coprincipals, and that the rule of contribution obtained among them. Smith v. Carr, 128 N.C. 150, 38 S.E. 732 (1901).

While all of the makers may appear as principals upon the face of the paper, or some principals and some sureties, yet it may be shown that while appearing as principals they were in fact sureties, or some principals and others sureties; and upon the establishment of the fact of co-suretyship, the right of contribution follows. Smith v. Carr, 128 N.C. 150, 38 S.E. 732 (1901).

Same — Issue Submitted. — In an action against the maker and endorsers of a note, an issue would be submitted as to whether or not the endorsers were cosureties, or whether one was a supplemental surety to the other. Parish v. Graham, 129 N.C. 230, 39 S.E. 825 (1901).

Suretyship May Be Alleged and Proved. — When sued, either of the defendants could allege that he was surety, and, if the allegation was proven, the jury in their verdict and the court in the judgment would distinguish the principal and surety, and it would be so endorsed on the execution issued for the collection of the judgment. Bank of Commerce & Trusts v. McArthur, 261 F. 97 (E.D.N.C. 1919), aff'd, 265 F. 1019 (4th Cir. 1920).

In Gatewood v. Leak, 99 N.C. 357, 6 S.E. 635 (1888), it was said: "If the appellee was surety, as he alleges, he might, as allowed by the statute (this section), have shown, by proper evidence on the trial in the actions in which the judgments were obtained by the appellant, that he was such surety, and the jury in their verdict, or the justice of the peace in his judgment, would have distinguished him as surety, and the executions would have been issued with a proper endorsement to that effect; and in that case the sheriff would have levied the sum required to be collected, first, out of the property of the principal if he had sufficient for that purpose."

Same — Practice of Courts. — It is not the practice of the courts to see that evidence of suretyship is produced and such fact inserted in the judgment, in the absence of the defendants and without any averment or request on their part. Morehead Banking Co. v. Duke, 121 N.C. 110, 28 S.E. 191 (1897).

Effect of Not Alleging Suretyship. — In Bank of Commerce & Trusts v. McArthur, 261 F. 97 (E.D.N.C. 1919), aff'd, 265 F. 1019 (4th Cir. 1920), it was said that: "It would not seem that, by failing to set up his suretyship in the action brought by the American National Bank on the note, McArthur lost any equitable rights against McBryde to which he was entitled as surety. It is true, as held in Gatewood v. Leak, 99 N.C. 357, 6 S.E. 635 (1888), that the surety, who has failed to set up the fact and have it found as provided by the statute, cannot enjoin the plaintiff in the judgment from proceeding to sell his land for its satisfaction. Neither McArthur nor plaintiffs may enjoin the bank from enforcing its judgment against himself until it has exhausted McBryde's property."

The magistrate is not bound to discriminate except upon the application of, and due proof by, the surety. Stewart v. Ray, 26 N.C. 269 (1844).

Effect of Finding of Jury. — Where a suit is brought at law against two persons, a finding of the jury that one of the defendants is principal, and the other surety, if binding at all between the parties, does not in equity establish the relation of suretyship. Lowder v. Noding, 43 N.C. 208 (1851).

When Execution Does Not Distinguish. — Where an execution against two does not distinguish which is principal and which surety, the sheriff has a right to collect it from either; and the sheriff may collect it from the surety, though the plaintiff in the execution directed him to collect it from the other. Shuford v. Cline, 35 N.C. 463 (1852).

Right of Surety to Assign Judgment. — It was stated in Barringer v. Boyden, 52 N.C. 187 (1859): "The right of a surety to keep alive a judgment, which he has paid, by having an assignment made to a stranger for his benefit, is unquestionable. When he advances the money, he has a clear equity (if he desires it) to be subrogated to the rights of the creditor, and to use the creditor's judgment for the purpose of coercing payment against the principal. Whether money advanced in such a way be an extinguishment or a purchase seems to be a question of intention. If it be paid, and nothing be said or done to show a contrary intendment, an extinguishment will be presumed; but if an assignment be made to one party, so as to show a purpose to keep it alive, it is sufficient. That a party defendant furnishes the money, and that the assignment is made on a day subsequent to the advancement of the money, can make no difference, provided it was intended, at the time it was advanced, as a purchase and not as a payment." Bank of Commerce & Trusts v. McArthur, 261 F. 97 (E.D.N.C. 1919), aff'd, 265 F. 1019 (4th Cir. 1920).

Signing on Faith of Creditor's Representations. — Persons signing a note as surety upon faith in the creditor's representation that another will sign as cosurety, leaving the note with the creditor for that purpose, are not bound thereon to such creditor upon the failure of the fulfillment of the representation. Bank of Benson v. Jones, 147 N.C. 419, 61 S.E. 193 (1908).

Bond Joint and Several on Face. — Although a bond is joint and several on its face, it can be shown by parol that a party thereto is a surety. Coffey v. Reinhardt, 114 N.C. 509, 19 S.E. 370 (1894).

Statute of Limitations. — If the purchaser of a note before maturity, for value and without notice, subsequently receives notice that a party thereto is a surety and delays action for three years after maturity, the surety will be protected by the three years' statute of limitations. Coffey v. Reinhardt, 114 N.C. 509, 19 S.E. 370 (1894).

Surety Held Liable for Face Value of Its Bond. — Where individual defendant as guardian of an incompetent and defendant insurance company as surety executed a bond and where nothing in the language of the bond indicated any intent that the bond be anything other than continuous, the bond clearly went to the entire administration of the estate, not to a single year of the administration and, thus, defendant insurance company's maximum liability over the entire term of guardianship was the face amount of the bond. State ex rel. Duckett v. Pettee, 50 N.C. App. 119, 273 S.E.2d 317 (1980).

Usury Defense Precluded. — A surety for a corporate debt answered "in behalf" of the corporation, within the plain meaning of G.S. 24-9, and was, under the plain meaning of that section, precluded from raising the defense of usury. Colonial Acceptance Corp. v. Northeastern Printcrafters, Inc., 75 N.C. App. 177, 330 S.E.2d 76 (1985).

Discharge in bankruptcy of debtor does not affect liability of any other entity on such debt. Exxon Chem. Ams. v. Kennedy, 59 N.C. App. 90, 295 S.E.2d 770 (1982).

§ 26-2. Principal liable on execution before surety.

When an execution, indorsed as aforesaid, shall come to the hands of any officer for collection, he shall levy on all the property of the principal, or so much thereof as shall be necessary to satisfy the execution, and, for want of sufficient property of the principal, also on the property of the surety, and make sale of all the property of the principal levied on before that of the surety. (1826, c. 31, s. 2; R.C., c. 31, s. 125; Code, s. 2101; Rev., s. 2841; C.S., s. 3962.)

CASE NOTES

Surety's Interest in Collateral. — The surety is entitled to the benefit of every additional or collateral security which the creditor gets into his hands for the debt for which the surety is bound, as soon as such a security is created, and by whatever means the surety's interest in it arises; and the creditor cannot himself, nor by any collusion with the debtor, do any act to impair the security or destroy the surety's interest. First Nat'l Bank v. Homesley, 99 N.C. 531, 6 S.E. 797 (1888).

§ 26-3. Summary remedy of surety against principal.

Any person who may have paid money for and on account of those for whom he became surety, upon producing to the clerk of superior court, a receipt, and showing that an execution has issued, and he has satisfied the same, and making it appear by sufficient testimony that he has expended any sum of money as the surety of such person, may move the clerk for judgment against his principal for the amount which he has actually paid; a citation having previously issued against the principal to show cause why execution should not be awarded; and should the principal not show sufficient cause, the clerk shall award execution against the principal. (1797, c. 487, s. 1, P.R.; R.C., c. 110, s. 1; Code, s. 2093; Rev., s. 2842; C.S., s. 3963; 1973, c. 108, s. 15.)

Legal Periodicals. — See 13 N.C.L. Rev. 116 (1935).

CASE NOTES

I. General Consideration.

II. Subrogation.
III. Assignments.

I. GENERAL CONSIDERATION.

Constitutionality. — This section, providing that a surety who shows that he has paid out money upon a judgment against his principal and himself may have a citation issued to the principal by the clerk to show cause why execution should not be awarded him therefor, is constitutional. Bank of N. Wilkesboro v. Wilkesboro Hotel Co., 147 N.C. 594, 61 S.E. 570 (1908).

A surety who has paid money for his principal cannot sue him in tort. Ledbetter v. Torney, 33 N.C. 294 (1850).

Notice to Corporation to Show Cause. — A notice issued by a court of competent jurisdiction, served upon the secretary and treasurer of a corporation, to show cause why an execution should not be awarded in favor of a surety who had paid a judgment against the corporation and himself, which set out the date and amount of the judgment, the relation of the parties, that the surety had actually expended money in payment of said judgment, and that the principal had not reimbursed him, was in compliance with the section. Bank of N. Wilkesboro v. Wilkesboro Hotel Co., 147 N.C. 594, 61 S.E. 570 (1908).

Validity of Order. — While the court could not revive a dormant judgment against the principal and the surety, an order otherwise valid was not rendered void by the addition of the words "that the judgment heretofore rendered is hereby revived, to the end that execution may be issued." The last sentence would be regarded as surplusage. Bank of N. Wilkesboro v. Wilkesboro Hotel Co., 147 N.C. 594, 61 S.E. 570 (1908).

When Surety Entitled to Action for Money Paid. — A judgment against a surety will not entitle him to maintain an action for money paid to the use of the defendant, until it has been satisfied. Hodges v. Armstrong, 14 N.C. 253 (1831).

To enable a surety to recover for money paid to the use of his principal, he must prove an actual payment in satisfaction of the debt. Hodges v. Armstrong, 14 N.C. 253 (1831).

The principal is not obligated to his surety until his surety has made a payment. American Nat'l Fire Ins. Co. v. Gibbs, 260 N.C. 681, 133 S.E.2d 669 (1963).

Right of Surety When Funds Misapplied. — Where a surety prays a judgment against his principal, he may recover any funds wrongfully converted or misapplied by the principal. Fidelity Co. v. Jordan, 134 N.C. 236, 46 S.E. 496 (1904).

Surety Cannot Trace Property. — A surety who has to pay the debt has no equity to follow the specific property which the principal debtor purchased with the borrowed money. Carlton v. Simonton, 94 N.C. 401 (1886).

Same — Bank Deposits. — Where the principal debtor borrowed a sum of money, which he deposited in a bank which soon afterwards became insolvent, and the surety had to pay the debt, the debt, the surety had no equity to enjoin the principal debtor from collecting the dividends from the insolvent bank, until he could recover a judgment. Carlton v. Simonton, 94 N.C. 401 (1886).

Where a writ is issued against two copartners for partnership debt, and one of them is arrested and gives bail, such bail, upon being afterwards compelled by due course of law to pay the debt, has no remedy except against the individual for whom he became bail. He has no claim upon the other partner. Foley v. Robards, 25 N.C. 177 (1842).

Where one indorsed a note at the request of a member of a firm for the purpose of obtaining money for the use of the firm, and the proceeds were so used, the indorser, upon payment of the note, can recover therefor against the firm, though no member of such firm signed the note. Springs v. McCoy, 122 N.C. 628, 29 S.E. 903 (1898).

Property mortgaged by an administrator to a surety to secure him against loss may be subjected to payment of estate debts, though the personal liability of the surety is barred. Hooker v. Yellowley, 128 N.C. 297, 38 S.E. 889 (1901).

A mortgage given by an administrator to a surety on his bond to secure the latter against loss inures to the benefit of the creditors of the estate. Hooker v. Yellowley, 128 N.C. 297, 38 S.E. 889 (1901).

The obligation of a bond for the forthcoming of property is only that the property shall be delivered to the officer at the time designated, and not that the execution shall be delivered to the officer at the time designated and not that the execution shall be satisfied; and therefore, if a surety to the forthcoming bond before it is forfeited discharges the execution without the request of his principal, such surety cannot maintain an action against his principal for money expended for the latter's use, although by the payment of the money in satisfaction of the execution the bond was discharged. Gray v. Bowls, 18 N.C. 437 (1836).

Bond of Guardian in Suit on Behalf of Ward. — Where a guardian, having given a bond for the prosecution of a suit by him on behalf of his ward and having signed the same individually, was compelled to pay the costs of the suit out of his individual estate, he could not recover the same under the provisions of this section, which gives a summary method for reimbursement of a surety who has paid money for another. Green v. Burgess, 117 N.C. 495, 23 S.E. 439 (1895).

II. SUBROGATION.

Subrogation Explained. — Subrogation is the substitution of another person in the place of a creditor, so that the former can succeed to the rights of the latter in relation to the debt; to entitle one to such equitable relief, he must have paid the money upon request or as surety or under some compulsion made necessary by the adequate protection of his own rights. Liles v. Rogers, 113 N.C. 197, 18 S.E. 104 (1893).

Legal subrogation is based upon payment and exists where one who has an interest to protect or is secondarily liable makes payment, while conventional subrogation, so named from the convention or agreement of the civil law, is founded upon the agreement of the parties, which really amounts to an equitable assignment. Liles v. Rogers, 113 N.C. 197, 18 S.E. 104 (1893); Commercial & Farmers Bank v. Scotland Neck Bank, 158 N.C. 238, 73 S.E. 157 (1911); Journal Publishing Co. v. Barber, 165 N.C. 478, 81 S.E. 694 (1914); Joyner v. Reflector Co., 176 N.C. 274, 97 S.E. 44 (1918).

The doctrine of equity, by which subsequent cases have been ruled, was first announced in the following terms: "By the fact of payment the surety becomes an equitable assignee of all such securities, and is entitled to have them assigned and delivered up to him by the creditor, in order that he may enforce them for his own reimbursement and exoneration. If, therefore, the creditor refuses to surrender up such securities, the surety may maintain an equitable suit to compel their assignment and surrender." Bank of Commerce & Trusts v. McArthur, 261 F. 97 (E.D.N.C. 1919), aff'd, 265 F. 1019 (4th Cir. 1920).

It is held that an endorser on a note may pay it and demand its delivery, and if the contract has been merged into a judgment, his right is to an assignment of the judgment and to enforce it for his own benefit. The principle is clearly stated by Prof. Langdell: "If payment of a debt be secured by a pledge of the debtor's property, and also by the obligation of a personal surety, and the surety pay the debt, equity will compel the creditor to deliver the pledge to him and not to the debtor, though the latter has a clear legal right to receive it, the debt being paid and extinguished; i. e., equity destroys the legal right of the debtor, and converts the creditor into a trustee for surety. This is done upon the theory that the debt is not paid by the surety, but is purchased by him, and that he is therefore entitled to the pledge as an incident of the debt. This, however, is only a fiction—a fiction, moreover, which is contrary to law, for the payment by the surety extinguishes the debt. Equity does this under the name of subrogation, and perhaps her best justification is that she borrowed both the name and the thing from the civil law." Bank of Commerce & Trusts v. McArthur, 261 F. 97 (E.D.N.C. 1919), aff'd, 265 F. 1019 (4th Cir. 1920).

A surety paying the debt of his principal is entitled to be subrogated to all the rights of the creditors, against a co-surety as well as against the principal, and this includes the right to have a judgment which he has paid assigned to a trustee for his benefit, so as to compel his co-surety to pay his pro rata part. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

In Brandt on Suretyship, G.S. 347, quoted in Tripp v. Harris, 154 N.C. 296, 70 S.E. 470 (1911), it is said: "A surety who pays the debt of his principal is entitled to subrogation to a mortgage given by the principal to the creditor for the security of the debt, and he may with or without a formal assignment thereof, have the same foreclosed in his own name, for his benefit."

Where a surety, as such, paid the whole of a debt, then the section gives him a right of action against co-sureties at law, and also such priority as the creditor would have had as a claimant against his principal's estate. Holden v. Strickland, 116 N.C. 185, 21 S.E. 684 (1895).

Rights Acquired. — The party for whose benefit the doctrine of subrogation is invoked and exercised can acquire no greater rights than those of the party for whom he is substituted, and if the latter had not a right of recovery the former can acquire none. Sheldon on Subrogation, G.S. 6; Clark v. Williams, 70 N.C. 679 (1874); Liles v. Rogers, 113 N.C. 197, 18 S.E. 104 (1893).

An endorser or surety who pays the indebtedness is subrogated to the rights of the creditor as against the property of the debtor. Ex parte Pittinger, 142 N.C. 85, 54 S.E. 845 (1906).

A surety to an administration bond who paid one half of a debt recovered against the insolvent administrator is not subrogated to the rights of the creditor whose debt he paid, but to the right of the administrator for whom he paid it. Clark v. Williams, 70 N.C. 679 (1874).

Same — Liens and Securities. — A surety who pays the debt is subrogated to all the specific liens and securities which the creditor has against the principal debtor. Carlton v. Simonton, 94 N.C. 401 (1886).

When Doctrine Cannot Be Invoked. — If a surety pays a judgment and has it entered "satisfied," without having it assigned to a trustee for his benefit, the remedy of subrogation is lost. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

Where several or successive obligations of suretyship are not in substance and nature for the same thing and have no relation to or operation upon each other, the doctrine of subrogation cannot be invoked. Liles v. Rogers, 113 N.C. 197, 18 S.E. 104 (1893).

Same — Corporation Note. — The endorsers on a note of a corporation secured by mortgage on its property are not entitled to subrogation, either legal or conventional, when it is ascertained that the note was paid by the corporation, and not the endorsers, and where there is evidence that the latter had paid it, the question should be submitted to the jury. Joyner v. Reflector Co., 176 N.C. 274, 97 S.E. 44 (1918).

Rights of Surety Against Party Receiving Money with Full Knowledge. — A surety company which has been called upon to pay a devastavit committed by its principal, an administrator, is entitled to be subrogated to the rights of the creditor against a party who received the money with knowledge of its wrongful appropriation, and his rights are exactly those of the creditor. Caviness v. Fidelity Co., 140 N.C. 58, 52 S.E. 265 (1905).

A surety, omitted in the deed of trust to secure the sureties, is entitled to be subrogated to the rights of his co-sureties pro tanto, if he has paid the debts, and the payees in the notes have a superior equitable right of subrogation to the benefit of any security given by the principal debtor to his sureties. Wiswall v. Potts, 58 N.C. 184 (1859); Harrison v. Styres, 74 N.C. 290 (1876); Ijames v. Gaither, 93 N.C. 358 (1885); Sherrod v. Dixon, 120 N.C. 60, 26 S.E. 770 (1897). And this is true whether they knew of it or not. Matthews v. Joyce, 85 N.C. 258 (1881); Blanton & Co. v. Bostic, 126 N.C. 418, 35 S.E. 1035 (1900).

III. ASSIGNMENTS.

Preservation of Lien by Assignment. — A surety may preserve the lien of judgment against the principal and himself by paying the judgment creditor and having the judgment assigned to a third person for his own benefit; and this also applies to a judgment against his co-sureties and himself in enforcing an equality of obligation between them. Fowle v. McLean, 168 N.C. 537, 84 S.E. 852 (1915).

A surety who pays the amount recovered against him and his principal, or co-sureties, may have the judgment assigned to another in trust for his use, and it will continue in force for his benefit; and he may, upon motion in the cause, have satisfaction of the judgment entered, even against the consent of the assignee. State v. Hearn, 109 N.C. 150, 13 S.E. 895 (1891).

Assignment of Right by Surety. — Where one of two defendants has paid a joint judgment upon a note against them both, and has the judgment assigned to another for his use, who brings action to recover against the other judgment debtor, he may, as between themselves, show that the defendant in the second action was the principal payee, and that he, the plaintiff, was an endorser, though not pleaded in the original action, and recover the full amount of the judgment he has paid, the action being, in substance, one by the surety on the note to recover against the principal thereon. Haywood v. Russell, 182 N.C. 711, 110 S.E. 81 (1921).

When One Half of Judgment Is Paid and the Other Assigned. — Where a surety paid and had satisfaction entered as to one half of a judgment against himself, his principal and a co-surety, and procured the judgment as to the other half to be assigned to a trustee for his benefit, it was in effect the same as if he had procured the whole judgment to be so assigned. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

When Assignment of Security Is Taken. — If an assignment of the security is taken, the surety may have his redress upon it immediately in the name of the creditor, but, while it is not in force, the surety can not maintain an action for the money paid for the assignment. Hodges v. Armstrong, 14 N.C. 253 (1831).

When Person Is Charged with Notice of Assignment. — Where a judgment against a principal and the sureties on a note is paid by the sureties, and an assignment thereof is made to a trustee for the benefit of the sureties, but by a mistake payment is entered on the judgment record, which is afterwards corrected by the entry thereon of the assignment, a person taking a mortgage on the property of the judgment debtor, after the assignment is entered on the record, takes with notice of the assignment. Patton v. Cooper, 132 N.C. 791, 44 S.E. 676 (1903).

§ 26-3.1. Surety's recovery on obligation paid; no assignment necessary.

(a) A surety who has paid his principal's note, bill, bond or other written obligation, may either sue his principal for reimbursement or sue his principal on the instrument and may maintain any action or avail himself of any remedy which the creditor himself might have had against the principal debtor. No assignment of the obligation to the surety or to a third-party trustee for the surety's benefit shall be required.

(b) The word "surety" as used herein includes a guarantor, accommodation maker, accommodation indorser, or other person who undertakes liability for the written obligation of another. (1959, c. 1120.)

CASE NOTES

A surety paying the debt of his principal is entitled to be substituted to all the rights of the creditor. Exxon Chem. Ams. v. Kennedy, 59 N.C. App. 90, 295 S.E.2d 770 (1982).

Sureties on bonds issued by principal cannot sue principal before paying all or part of the penal amount of the bonds. Harshaw v. Mustafa, 321 N.C. 288, 362 S.E.2d 541 (1987).

Time of Suit. — This section allows a surety to sue a principal on the original instrument or for reimbursement on the surety agreement. After three years, a suit on the latter theory would be barred by G.S. 1-52. Where surety elects to sue on the underlying note under seal, he has the same rights the bank had on the original note. Thus, the 10-year statute of limitations, G.S. 1-47, would apply. Adams v. Bass, 88 N.C. App. 599, 364 S.E.2d 194 (1988), cert. denied, 326 N.C. 363, 389 S.E.2d 810 (1990).

§ 26-4. Subrogation of surety paying debt of deceased principal.

Whenever a surety, or his representative, shall pay the debt of his deceased principal, the claim thus accruing shall have such priority in the administration of the assets of the principal as had the debt before its payment. (1829, c. 23; R.C., c. 110, s. 4; Code, s. 2096; Rev., s. 2843; C.S., s. 3964.)

CASE NOTES

Scope. — This section, which confers on the claim of a surety paying the debt for which he is surety the dignity, in the administration of the assets of the principal, which the debt, if unpaid, would have had, applies to a judgment, whether the payment be made before or after the death of the principal. Drake v. Coltrane, 44 N.C. 300 (1853).

When Co-Surety Deemed Bond Creditor. — A co-surety, who pays the bond debt for which the other surety is equally bound, shall be deemed a bond creditor in the administration of the estate of the deceased co-surety, under the Act of 1828 as construed in Drake v. Coltrane, 44 N.C. 300 (1853); Howell v. Reams, 73 N.C. 391 (1875).

When a plaintiff, a co-surety, discharged the bond debt, for the payment of which the defendant's intestate was equally bound, he became a bond creditor as to the assets of the intestate; and when, pending an action for contribution, the administrator paid off the bonds voluntarily, of equal dignity with said surety debt, having previously paid an open account, he committed a devastavit to the extent of the plaintiff's claim for contribution, such claim being for a sum smaller than the bonds so preferred and the open account. Howell v. Reams, 73 N.C. 391 (1875).

For case in which this section was applied in subrogating widow to rights of mortgagee where policy in which she was named beneficiary was assigned to and paid to mortgagee, see Russel v. Owen, 203 N.C. 262, 165 S.E. 687 (1932).

Cited in Brown v. McLean, 217 N.C. 555, 8 S.E.2d 807 (1940).

§ 26-5. Contribution among sureties.

Where there are two or more sureties for the performance of a contract, and one or more of them may have been compelled to perform and satisfy the same, or any part thereof, such surety may have and maintain an action against every other surety for a just and ratable proportion of the same which may have been paid as aforesaid, whether of principal, interest or cost. (1807, c. 722, P.R.; R.C., c. 110, s. 2; Code, s. 2094; Rev., s. 2844; C.S., s. 3965; 1957, c. 981.)

CASE NOTES

I. The Right to Contribution Generally.
II. When Surety Obtains Advantage over Co-Sureties.
III. Contribution Enforced.
  A. In General.
  B. Actions and Incidents Thereof.

I. THE RIGHT TO CONTRIBUTION GENERALLY.

Rule of Contribution. — The rule of contribution is founded upon the maxim that "equality is equity," and not upon contract. It is a rule of a common justice whereby parties who undertake to account for the default or miscarriage of another should equally bear the burden imposed by a failure of their principal. As between them, there is no agreement implied, but an equitable presumption raised by the fact of the payment by one, that the others will equalize the burden thus borne by him, by paying to him such sums as will make the loss equal upon each, which can be rebutted by showing that there was an agreement, whether verbal or written, to the contrary. Smith v. Carr, 128 N.C. 150, 38 S.E. 732 (1901). See Allen v. Wood, 38 N.C. 386 (1844).

This maxim can only be applied to those whose situations are equal; otherwise equality is not equity, and hence if one surety stipulates for a separate indemnity, the equality of situation between him and his co-surety ceases, and the maxim does not apply. Moore v. Moore, 11 N.C. 358 (1826).

It is broadly stated in 2 Brandt Suretyship 309, that "A surety who pays his principal's debt is entitled to be subrogated to all the rights and remedies of the creditor against his co-surety in the same manner as against the principal." This is founded in reason and justice, and up to the adoption of our present Constitution was enforced in the courts of equity. N.C. Const., Art. IV, § 1 abolished the distinction between actions at law and suits in equity, leaving such rights and remedies to be enforced in the one court, which theretofore had administered simply legal rights. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

The liability of sureties among themselves is controlled by the equitable principle of equality arising out of a common risk, and in case of insolvency or nonresidence these rights are adjusted by reference to the number of sureties who are solvent or who have property available to process within the jurisdiction of the court. Fowle v. McLean, 168 N.C. 537, 84 S.E. 852 (1915).

Same — Primary and Conditional Liability. — The equitable doctrine of contribution is enforced upon the principle that those engaged in a common hazard in the same degree or relation should bear the loss equally, but where one is surety and the others endorsers, the liability of the former is primary and of the latter a conditional one, and not being in the same situation with regard to the hazard, the surety is not entitled to contribution from the endorsers. Edwards v. Jefferson Std. Life Ins. Co., 173 N.C. 614, 92 S.E. 695 (1917).

Rebuttable Presumption of Equal Liability. — Co-principals and co-sureties are presumed to assume equal liability, but this presumption may be rebutted by parol evidence. Smith v. Carr, 128 N.C. 150, 38 S.E. 732 (1901).

Surety for Other Sureties. — It is entirely competent for one person to become surety for other sureties, or to limit the extent of his liability with respect to other sureties. The test of liability is the intent of the parties as indicated by their agreement. Citizens Nat'l Bank v. Burch, 145 N.C. 316, 59 S.E. 71 (1907).

Sureties on Successive Guardianship Bonds. — The sureties to the successive bonds of a guardian stand in the relation of co-sureties, one bond to the other or others, and are liable, in case of insolvency of the guardian, to contribution in proportion to the amount of the several penalties of the bonds. The risk they take is a joint risk, and there is an implied engagement or obligation, each set of sureties with the other, to bear any loss which may fall on them proportionally, as above stated; or, if it is borne by one class, to contribute by way of reimbursement. Bell v. Jasper, 37 N.C. 597 (1843); Jones v. Hays, 38 N.C. 502 (1845); Bright v. Lennon, 83 N.C. 184 (1880).

Where a guardian gives several successive bonds for the faithful discharge of his trust, the sureties on each bond stand in the relation of co-sureties to the sureties on every other bond; the only qualification to the rule being that the sureties are bound to contribution only according to the amount of the penalty of the bond in which each class is bound. Jones v. Hays, 38 N.C. 502 (1845).

All the bonds given by a guardian are but securities for the same thing, and the sureties on each are bound to contribution, but their liabilities are in proportion to the amount of their respective bonds. Jones v. Blanton, 41 N.C. 115 (1848).

When Surety Should Answer for Default and Stop Costs. — As a general rule, upon the default and insolvency of a principal, a surety should answer for the default, and not unnecessarily let costs be run up where the liability and amount thereof is clear. But where the guardian claimed to have settled with and paid the wards, it was prudent in plaintiff in regard to his own interests and as an act of justice to his co-sureties on other bonds to incur costs to the point of developing how the fact of alleged settlement was, and to this effect are the authorities. Bright v. Lennon, 83 N.C. 184 (1880).

The costs incurred by one surety, or one set of sureties, are not always to be regarded as a loss borne to which in equity contribution may be had, but it would seem to depend on the prudence and bona fides of the defense by which they were incurred. Bright v. Lennon, 83 N.C. 184 (1880).

Assets Given Up by Mistake of Law. — Where A and B were co-sureties on an administration bond, and were sued upon the same by one of the next of kin, and while the suit was pending compromised the same under the advice of counsel and from an honest belief that both were liable to a larger sum on account of the devastavit and insolvency of their principal, and it was afterwards discovered that B, who had administered on the estate of the principal, had, by a misapprehension of law, but acting under legal counsel, and in good faith, erroneously given up assets of their principal to another claim, which, if they had been held by him, would have saved them both from loss by this suretyship, it was held that A could not sustain a bill to throw the whole loss on B, there being no evidence that B had concealed from A the fact of having thus parted with the assets, there being no allegation of fraud or imposition on the part of B. Brandon v. Medley, 54 N.C. 313 (1854).

Release of Principal. — A surety who seeks to recover from a co-surety a ratable part of money paid must take care to do no act which will prevent the co-surety from having recourse against the principal. If, therefore, he releases the principal, it is a discharge of the co-surety. Draughan v. Bunting, 31 N.C. 10 (1848).

Sureties on Sheriff's Tax Bond. — The right of contribution does not exist between sureties of the different bonds of a sheriff as tax collector. McGuire v. Williams, 123 N.C. 349, 31 S.E. 627 (1898).

When One Surety in Fact Surety for Co-Surety. — Where A and B signed a negotiable note apparently as joint principals, when, in fact, the latter was surety for the former and the appellant signed the note by writing his name across the back, with the word "surety" underneath, it was held that in the absence of any evidence that appellant knew of the relation between the makers, he was surety for the two, and that surety B could not compel contribution. Citizens Nat'l Bank v. Burch, 145 N.C. 316, 59 S.E. 71 (1907).

Release by Securing Part of Debt. — If there are several sureties for the same principal, and one of them is fixed with the payment of the whole debt, or of more than his ratable part thereof, the others, who are solvent, shall be compelled to contribute, in order to equalize the loss. But if by any agreement between the sureties, one of them is released by the creditor, upon his securing the payment of a certain part of the debt, he shall not afterwards be called upon to contribute to one or more of the remaining sureties, for a loss arising from the deficiency of another to them. Moore v. Isley, 22 N.C. 372 (1839).

Agreement Between Sureties. — There can be no doubt that after two persons have become sureties for a common principal they may, by agreement between themselves, renounce their right to take benefit from any securities they may respectively obtain, and each look out for himself exclusively for an indemnity from the principal or for contribution from another co-surety. Long v. Barnett, 38 N.C. 631 (1845); Commissioners of McDowell County v. Nichols, 131 N.C. 501, 42 S.E. 938 (1902).

Where the land of one of two sureties of a third person was sold under execution for the debt, and the other surety and a third person bid it off, it was held that an agreement by the surety who owned the land to take the whole debt upon himself and satisfy the execution in return for an assignment of the bid to him was a promise to pay his own debt and was not affected by the statute of frauds; and in such case the surety who paid could not obtain contribution from his co-surety. Hockaday v. Parker, 53 N.C. 16 (1860).

Where one of two sureties claims to be a supplemental surety by agreement, the burden is upon him to show the agreement. Carr v. Smith, 129 N.C. 232, 39 S.E. 831 (1901).

Surety May Contract for Different Indemnity. — This section does not say that parties may not by contract agree to different rights than are provided by the statute. A surety may contract for a different indemnity than he would be given by law in the absence of such an agreement. Hofler v. Hill, 58 N.C. App. 201, 293 S.E.2d 238 (1982), modified and aff'd, 311 N.C. 325, 317 S.E.2d 670 (1984).

Doctrine of Contribution Applied. Atwater v Farthing, 118 N.C. 388, 24 S.E. 736 (1896), was a case where A endorsed a note for the maker, and subsequently, but before it was discounted, F endorsed it. The principal became insolvent and left the State. A paid the note. The court held that F was a co-surety and that the doctrine of contribution was applicable for A's benefit. The court said that the decision was governed by Daniel v. McRae, 9 N.C. 590 (1823) and Dawson v. Pettway, 20 N.C. 531 (1839).

II. WHEN SURETY OBTAINS ADVANTAGE OVER CO-SURETIES.

Property Advanced by Principal to One of Sureties. — Where money is advanced by the principal to one of the sureties, to discharge the debt, before the debt is actually discharged, the co-surety may file his bill in equity for an account and for relief, but if the money is paid by the principal after the debt has been discharged by the sureties, to one of two sureties, to reimburse both, then the co-surety has his remedy against the surety receiving the money, by an action at law for money had and received, and therefore cannot support a suit in equity. Allen v. Wood, 38 N.C. 386 (1844).

An indemnity obtained from a principal by one of two co-sureties, after the risk is incurred, inures equally to the benefit of both. Pool v. Williams, 30 N.C. 286 (1848).

Where the principal placed property in the hands of a surety sufficient to satisfy the debt, and then left the State, it was held that a third person, also bound for the debt as surety, having been compelled to pay it, might recover its amount from the person who had received the property without making a previous demand. Parham v. Green, 64 N.C. 436 (1870).

When two persons engage in a common risk as sureties for a third and one of them subsequently takes an indemnity from the principal debtor it inures to the benefit of both. Fagan v. Jacocks, 15 N.C. 263 (1833); Gregory v. Murrell, 37 N.C. 233 (1842); Hall v. Robinson, 30 N.C. 56 (1847).

Separate Indemnity. — In Long v. Barnett, 38 N.C. 631 (1845), the court said: "As one, when he is about to become a surety with others, may stipulate for a separate indemnity from the principal to him, and the co-sureties would be only entitled to a surplus after his reimbursement. Moore v. Moore, 11 N.C. 358, 15 Am. Dec. 523 (1826)." Commissioners of McDowell County v. Nichols, 131 N.C. 501, 42 S.E. 938 (1902).

When Indemnity May Be Reached. — The indemnity taken by one surety can be reached by the other only in two cases, either when it was taken in fraud, or for the benefit of the other. Moore v. Moore, 11 N.C. 358 (1826).

Before and After Severance of Relationship. — While the relation of joint sureties exists, funds received by one of them (except under special circumstances) for the discharge of, or as an indemnity against, his liability, are to the applied for the common benefit of the sureties. But after that connection has been severed by an agreement among the sureties, each of them has his distinct and several claim to prosecute, because of what he has paid for his principal, or for an insolvent joint surety; and the others have no right to demand participation in what his diligence may enable him to procure, while thus prosecuting his several claims. Moore v. Isley, 22 N.C. 372 (1839).

When Advantage Lost by Laches. — Where the surety merely had a deed of trust for certain property, as an indemnity, executed by the principal, and neglected to have it registered, so that the property was sold by other creditors, the co-surety was not entitled, on account of this laches, to make him responsible for the value of the property. Pool v. Williams, 30 N.C. 286 (1848).

Parties. — One of three joint solvent sureties cannot sustain a bill against either of his co-sureties for contribution out of a fund alleged to have been received by that surety for this indemnity from the estate of an insolvent co-surety, without making the other a party. Moore v. Isley, 22 N.C. 372 (1839).

III. CONTRIBUTION ENFORCED.

A. In General.

Accommodation Maker and Endorser. — An accommodation maker who pays a note may recover contribution from an accommodation endorser of the note where they intended to become co-sureties. Gilliam v. Walker, 189 N.C. 189, 126 S.E. 424 (1925).

Co-Surety Paying Bond Debt Deemed Bond Creditor. — In Howell v. Reams, 73 N.C. 391 (1875), it was held that a co-surety who pays the bond debt, for which the other surety is equally bound, shall be deemed a bond creditor in the administration of the estate of the deceased co-surety. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

Liability for Ratable Part of Debt Only. — The section provides that where one or more sureties have been compelled to satisfy the contract of their principal, they may sue their co-sureties for their ratable part of the debt paid for the principal. Peebles v. Gay, 115 N.C. 38, 20 S.E. 173 (1894).

There was a judgment against the principal and two sureties, and an execution levied on the property of one of the sureties. A bought this property from this surety, pending the levy, and afterwards obtained an assignment of the judgment to enable him to have the whole amount satisfied out of the property of the co-surety, and issued an execution for that purpose. It was held that he was restrained from collecting out of the co-surety more than the fair proportion which the latter owed, whether A had actual notice of the lien of the execution or not. Dobson v. Prather, 41 N.C. 31 (1849).

Rights of Surety Paying Entire Debt. — Under the Act of 1807, now this section, one surety may recover at law from another his ratable proportion of the debt of the principal, but the rights of the surety who pays the debt are not enlarged, nor is the co-surety deprived of any just grounds of defense which would before have been available to him in equity. Hall v. Robinson, 30 N.C. 56 (1847).

A surety who, pursuant to his contractual obligation, pays the debt of his principal has a right of action to recover the sum so paid. American Nat'l Fire Ins. Co. v. Gibbs, 260 N.C. 681, 133 S.E.2d 669 (1963).

This section affords a right to one surety, who has paid a debt for which he and another are equally liable, to call on the other for contribution. American Nat'l Fire Ins. Co. v. Gibbs, 260 N.C. 681, 133 S.E.2d 669 (1963).

In Case of Absent Co-Surety. — A co-surety must make contribution, without regard to the share of contribution which the absent co-surety would have had to pay had he been within the reach of the process of North Carolina courts. Jones v. Blanton, 41 N.C. 115 (1848).

Accommodation Endorser Not Liable as Co-Surety. — Where A, as surety, signed the note of B, payable to C, and it was endorsed by C, at the request and for the accommodation of B, there being no contract between A and C whereby they agreed to become co-sureties of B, it was held that A had no right to contribution from C. Smith v. Smith, 16 N.C. 173 (1828).

Liability Need Not Be Fixed by Judgment. — It is not necessary, to entitle a surety to maintain an action for contribution, that the amount of his liability which was paid by him should be fixed by a judgment. Bright v. Lennon, 83 N.C. 184 (1880).

Statute of Limitations. — In the case of a surety's payment and action for contribution against the co-surety, the statute of limitations runs only from the payment. Sherrod v. Woodward, 15 N.C. 360 (1833); Craven v. Freeman, 82 N.C. 361 (1880).

A surety who pays money for his principal may maintain an action against his co-surety for his ratable part, without first making a demand, and the statute of limitations begins to run from the time of the payment of the money. Sherrod v. Woodward, 15 N.C. 360 (1833).

While the right to contribution among co-indemnitors or sureties has common law origin, since 1807 it has been a statutory right under the provisions of this section; accordingly, the applicable statute in this case provided that an action upon a liability created by statute must be brought within three years. Finch v. Barnes, 102 N.C. App. 733, 403 S.E.2d 552, rev'd on other grounds sub nom. State v. Case, 330 N.C. 192, 410 S.E.2d 57 (1991).

Same — Failure to Plead. — A surety when sued is not bound to plead the statute of limitations, but may or may not according to his discretion. Jones v. Blanton, 41 N.C. 115 (1848); Street v. Board of Comm'rs, 70 N.C. 644 (1874); Craven v. Freeman, 82 N.C. 361 (1880). And if so, the withdrawal of such a plea or a waiver of it ought not to affect and does not affect the right to contribution. The design of that plea is to protect against a false and unjust claim or one of whose discharge the evidence is lost, but it is not obligatory in morals or law to use it to defeat a just debt. Bright v. Lennon, 83 N.C. 184 (1880).

A surety to a guardian bond, when sued by the wards, is not bound to avail himself of the statute of limitations, and a failure to do so does not release co-sureties. Jones v. Blanton, 41 N.C. 115 (1848).

B. Actions and Incidents Thereof.

A surety's right of action accrues at the time of payment, not before. American Nat'l Fire Ins. Co. v. Gibbs, 260 N.C. 681, 133 S.E.2d 669 (1963).

Action at Law for Aliquot Parts. — An action at law by surety for contribution lies only against the co-sureties, severally, for the aliquot part due from each. Adams v. Hayes, 120 N.C. 383, 27 S.E. 47 (1897).

Where two sureties on a note to a bank agreed, after the insolvency of their principal, to employ a broker to buy notes of the bank to an amount sufficient to pay the debt, and one of them paid the broker for notes purchased by him, and discharged the debt, it was held that he could maintain an action on the case against his co-surety for contribution. DeRossett v. Bradley, 63 N.C. 17 (1868).

Surety Should Allege Principal's Insolvency. — When one surety brings a bill for contribution against a co-surety, he should at least allege that the principal is insolvent, so that he can have no redress against him; for the equity of a plaintiff, seeking contribution from a co-surety, lies in the insolvency of the principal. Allen v. Wood, 38 N.C. 386 (1844).

A surety has no right to call upon his co-surety in equity for contribution, without showing that he could not obtain satisfaction for the amount he has paid from their common principal. Rainey v. Yarborough, 37 N.C. 249 (1842).

When Insolvency Not Alleged and Improper Relief Asked. — Where a complaint in an action by a surety for contribution joined the principals as parties, and alleged the contract of suretyship, payment by the plaintiff and demand of the co-sureties "for their contributive shares," and asked judgment against all, but did not allege insolvency of the principal except by the averment that plaintiff was compelled to pay the debt, it was held that, though the proper relief was not asked, and the insolvency of the principals was imperfectly alleged, the cause of action would be construed, on demurrer, as equitable rather than legal, in order to confer jurisdiction below. Adams v. Hayes, 120 N.C. 383, 27 S.E. 47 (1897).

Costs Paid by Plaintiff. — In an action by a surety of an insolvent guardian for contribution against other sureties, it is proper to include in the sum adjudged to be raised by contribution costs which were paid by plaintiff in an action against him as a condition for leave to plead the statute of limitations. Bright v. Lennon, 83 N.C. 184 (1880).

When Surety Must Show Actual Money Payment. — Where a surety brings an action of assumpsit, for money paid for the use and at the request of the defendant, against his co-surety, to obtain contribution, it is not sufficient for him to show that he has given his note for the debt due by the principal, and that the same has been accepted by the creditor as a payment and discharge of the debt. To entitle him to recover in his action, he must prove an actual payment in money, or in money's worth, such as bank notes, the note of a third person, or a horse or the like, which is valuable in itself to the surety who parts with it. Brisendine v. Martin, 23 N.C. 286 (1840).

Notice. — In an action for contribution by a surety against four different guardian bonds, with different penalties and different sureties, some solvent and some otherwise, it is not necessary that notice should be given before the action is brought. Bright v. Lennon, 83 N.C. 184 (1880).

Right to Demand Waived. — Where the plaintiff brings suit for contribution against a co-surety on a note, alleging defendant's liability as such, and that defendant had failed or refused reimbursement to the extent of his liability to the plaintiff, who had paid the same, and the defendant answers, denying liability, and there is no averment that demand had been previously made on the defendant, the right to a demand is waived by the answer, and the statement of the cause of action, being only defective, is cured. Shuford v. Cook, 164 N.C. 46, 80 S.E. 61 (1913).

What Co-Sureties Must Be Made Parties. — A surety who has been compelled to pay the debt of his principal must make all his co-sureties parties to a bill for contribution if they are in this State and solvent. But where one is out of the jurisdiction of the court, and others are within it, the plaintiff, by stating the fact in his bill, is at liberty to proceed against the latter alone. Jones v. Blanton, 41 N.C. 115 (1848).

Principal or Executor Party Defendant. — To a bill brought by one surety against his co-surety for contribution, their common principal, or, if he be dead, his executor or administrator should be made a party defendant. Rainey v. Yarborough, 37 N.C. 249 (1842).

Bankruptcy of Principal. — Where it appeared that the principal on a note had secured his discharge in bankruptcy from his obligations, including a note paid at maturity by one of two sureties thereon, and that a few months thereafter the surety who paid the note brought his action for contribution against his co-surety, who had paid nothing, the right of action given by Revisal, G.S. 2844, now this section, would not, without more, be denied upon the ground that it required the insolvency of the principal, in such cases, to be shown at the institution of the action. Shuford v. Cook, 164 N.C. 46, 80 S.E. 61 (1913).

Interest on Collaterals. — In an action against an alleged co-surety to recover money paid in settlement of their joint liability, the amount received by the plaintiff as interest on collaterals deposited should be deducted from the amount paid by plaintiff. Carr v. Smith, 129 N.C. 232, 39 S.E. 831 (1901).

Discharge of Levy by Co-Surety. — A, having a judgment against B, as principal, and C, as surety, C, without the consent of A, has an execution issued and levied upon B's property. A has a right to withdraw the execution and discharge the levy, without making herself liable to C. Forbes v. Smith, 40 N.C. 369 (1848).

Principal's Reputation as Evidence of History of Insolvency. — In an action for contribution by a surety against his co-surety, the plaintiff may offer evidence of their principal's insolvency by showing his general reputation, and this even after direct evidence of the said principal's insolvency. Leak v. Covington, 99 N.C. 559, 6 S.E. 241 (1888).

Record of Judgment in Evidence. — A surety seeking contribution from a co-surety can offer in evidence the record of a judgment against the surety as such, which, in the absence of any suggestion of fraud or collusion in procuring the same, is prima facie proof of the damages suffered by the said surety. Leak v. Covington, 99 N.C. 559, 6 S.E. 241 (1888).

Operation of Parol Evidence Rule. — The rule that parol evidence cannot be admitted to contradict a written contract applies to actions on the contract itself, but not to such as arise collaterally out of it. So where it appeared on the face of a note that certain parties thereto were sureties, in an action for contribution, parol evidence was admissible to show that they were really principals. Williams v. Glenn, 92 N.C. 253 (1885).

§ 26-6. Dissenting surety not liable to surety on stay of execution.

Whenever any judgment shall be obtained against a principal and his surety, and the principal debtor shall desire to stay the execution thereon, but the surety is unwilling that such stay shall be had, the surety may cause his dissent thereto to be entered by the judge or clerk, which shall absolve him from all liability to the surety who may stay the same. And the sheriff or other officer, who may have the collection of the debt, shall make the money out of the property of the principal debtor, and that of the surety for the stay of execution, if he can, before he shall sell the property of the surety before judgment. (1829, c. 6, ss. 1, 2; R.C., c. 110, s. 3; Code, s. 2095; Rev., s. 2845; C.S., s. 3966; 1973, c. 108, s. 16.)

§ 26-7. Surety, indorser, or guarantor may notify creditor to take action.

(a) After any note, bill, bond, or other obligation becomes due and payable, any surety, indorser, or guarantor thereof may give written notice to the holder or owner of the obligation requiring him to use all reasonable diligence to recover against the principal and to proceed to realize upon any securities which he holds for the obligation.

(b) The surety, indorser or guarantor who gives notice to the holder or owner of the obligation as provided by subsection (a) shall forthwith give written notice to all co-sureties, co-indorsers and co-guarantors of the fact that such notice is being given to the holder or owner of the obligation, and such co-sureties, co-indorsers and co-guarantors shall have ten days after receipt of the notice in which themselves to give written notice to the holder or owner of the obligation and to their co-sureties, co-indorsers, and co-guarantors, that they join in or adopt the notice given pursuant to subsection (a). Failure of such surety, indorser or guarantor to give the required notice to co-sureties, co-indorsers or co-guarantors whose names and residences are known to him or can be obtained by due diligence bars such surety indorser or guarantor from any of the benefits of G.S. 26-9.

(c) The holder or owner of the obligation shall on demand disclose to any surety, indorser, or guarantor of the obligation the names and addresses of all other sureties, indorsers and guarantors which appear on the obligation or of which he has knowledge.

(d) Nothing herein contained shall apply to official bonds, or bonds given by any person acting in a fiduciary capacity. (1868-9, c. 232, s. 1; Code, s. 2097; Rev., s. 2846; C.S., s. 3967; 1951, c. 763, s. 1.)

Cross References. — As to statute of limitations, see G.S. 1-52 (1) and (6).

Legal Periodicals. — For brief comment on the 1951 amendment of this section and G.S. 26-8 and 26-9, see 29 N.C.L. Rev. 413 (1951).

CASE NOTES

I. General Consideration.
II. Decisions Under Prior Law.

I. GENERAL CONSIDERATION.

Scope of Protection. — G.S. 26-7, while it provides guarantors with certain protections, does not protect them from litigation in the event that the creditor fails to exhaust his remedies against the principal; rather, the statutory scheme created by the North Carolina legislature permits a court to discharge the obligation of the guarantor to the extent that the guarantor is prejudiced by the creditor's delay in proceeding against the principal; so the guarantor's argument that the application of G.S. 26-7 required a federal court to abstain from exercising its jurisdiction was without merit. Nat'l Textiles, LLC v. Daugherty, 250 F. Supp. 2d 575, 2003 U.S. Dist. LEXIS 2135 (M.D.N.C. 2003).

"Principal". — This section does not refer to the principal of the guaranty, but rather, it refers clearly to the principal debtor on the indebtedness or obligations underlying the guaranty. Gillespie v. DeWitt, 53 N.C. App. 252, 280 S.E.2d 736, petition for cert. denied, 304 N.C. 390, 285 S.E.2d 832 (1981).

Finding that language in guarantees served only to identify the guaranty as guaranty of payment and was not intended to waive this section comported with the rules of construction and the case law and would be upheld. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

In the parties' guaranty agreement, defendant promised not only to be liable for the entire balance of the note when it became due and payable upon a default, but also to make payment of any delinquent full installment, including delinquent interest 30 days after he had been given written notice of the default. Thus defendant's written promise to pay each individual installment upon default created an obligation covered by subsection (a) of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

To be relevant on issue of implied waiver, evidence must show that defendant acted in manner which induced plaintiff to believe defendant intended to waive provisions of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by this section through G.S. 26-9. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with this section. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installment payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under this section through G.S. 26-9, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Under this statute, plaintiff's refusal to move against either farm or the farm's collateral to collect the balance of the note due released defendant, as guarantor, only to the extent he was prejudiced. If the solvency of the farm and the value of its collateral were equivalent to the same values existing when note became due, when defendant gave plaintiff this section's notice, defendant would not have been prejudiced by plaintiff's failure to act and would have continued to be liable for the entire amount of the note he originally guaranteed. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Applied in Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases cited below were decided prior to the 1951 amendment, which rewrote this section.*

Reasonable Compliance. — The requirements of this section are reasonably complied with when the holder of a negotiable note, after receiving notice in accordance with this section, within thirty days causes the maker to be a party defendant, and it is made to appear that he is a nonresident. Taylor v. Bridger, 185 N.C. 85, 116 S.E. 94 (1923).

Written Notice Required. — To have the benefit of the next preceding section and so that there may be no controversy as to whether the demand is sufficient to have this effect, a notice in writing must be given to the creditor; and its benefits are secured to such only as give the notice if there is more than one surety. First Nat'l Bank v. Homesley, 99 N.C. 531, 6 S.E. 797 (1888).

Protection Secured. — In Moore v. Goodwin, 109 N.C. 218, 13 S.E. 772 (1891), it was held that payment made by a principal upon a bond, before the cause of action thereon is barred against the sureties, arrests the operation of the statute of limitations.

This section affords relief to securities in cases not provided for in the preexisting law, by requiring the creditor, at the instance of the surety who considers himself in danger of loss from his contingent liability, to bring suit, and use reasonable diligence in making his money from the principal, and saving harmless the surety, at the hazard of losing his claim upon the latter, if negligent in doing so. But official bonds or securities held as collateral are excepted from the operation of this section; nor does it reach a case where the requirement of the sureties was verbal only, if in other aspects applicable to such case. First Nat'l Bank v.

Homesley, 99 N.C. 531, 6 S.E. 797 (1888).

Where an action was brought upon a negotiable instrument the defendants on its face being joint makers, the mere fact that the plaintiff had told one of the defendants, without the knowledge of the other, "that he would take up and carry the note until fall," was held to constitute an extension of payment for a "fixed and definite" period, which would operate as a release to such other from liability, but his remedy was by quia timet notice under this section. Roberson-Ruffin Co. v. Spain, 173 N.C. 23, 91 S.E. 361 (1917).

Same — Endorser in Blank of Nonnegotiable Paper. — The rights of an endorser in blank upon a nonnegotiable note are sufficiently protected under the section, which provides that a surety or endorser on any note, bill, bond or written obligation, except those held in trust or as collateral, may notify, in writing, the payee or holder, requiring him to bring suit and use all diligence to collect, and if the payee or holder refuses to bring action within thirty days, the surety or holder giving notice is discharged. Johnson v. Lassiter, 155 N.C. 47, 71 S.E. 23 (1911).

Surety Released After Thirty Days. — The surety can give the holder written notice quia timet to bring suit under this section, and if the holder does not do so within thirty days the surety will be released. Cole v. Fox, 83 N.C. 463 (1880); Coffey v. Reinhardt, 114 N.C. 509, 19 S.E. 370 (1907).

Legal Duty of Principal. — Except when required by written notice under this section, it is not the legal duty of the principal to institute a suit against the debtor, or to pursue such a suit with diligence and to call to his aid all of the remedies provided by the law. Bell v. Howerton, 111 N.C. 69, 15 S.E. 891 (1892).

When Inapplicable. — Where there is an agreement in a negotiable note that the endorsers will continue to be bound notwithstanding an extension of time granted to the maker, the endorsers cannot avail themselves of the provisions of this section, when the maker is a nonresident, and demand for payment after dishonor has been made upon the resident endorsers, defendants in the action, and they have delayed to give the statutory notice until after action has been commenced. Taylor v. Bridger, 185 N.C. 85, 116 S.E. 94 (1923).

§ 26-8. Notice; how given; prima facie evidence thereof.

(a) Any notice authorized or required to be given by G.S. 26-7 shall—

(1) Be served by the sheriff by delivering a copy thereof to the person entitled to the notice, or

(2) Be sent by the person giving notice, by registered mail, with return receipt requested, to the last known address of the person being notified.

(b) Upon serving the notice, the sheriff shall return the original thereof, with his return thereon, to the person who caused the notice to be given.

(c) The sheriff's return, when the notice is served by the sheriff, or the return receipt, when the notice is sent by registered mail, shall be prima facie evidence of the giving of the notice. (1868-9, c. 232, s. 3; Code, s. 2099; Rev., s. 2848; C.S., s. 3968; 1951, c. 763, s. 2.)

§ 26-9. Effect of failure of creditor to take action.

(a) If the holder or owner of the obligation refuses or fails, within 30 days from the service or receipt of such notice, to take appropriate action pursuant thereto, the following persons shall be discharged on any such note, bond, bill or other obligation to the extent that they are prejudiced thereby:

(1) The surety, indorser or guarantor giving such notice, and

(2) All co-sureties, co-indorsers or co-guarantors joining therein or adopting such notice as provided by G.S. 26-7, and

(3) All the co-sureties, co-indorsers, or co-guarantors whose names or addresses such holder or owner of the obligation failed to disclose on demand as required by subsection (c) of G.S. 26-7.

(b) The fact that an instrument contains a provision waiving any defense of any surety, indorser or guarantor by reason of the extension of the time for payment does not prevent the operation of this section. Any such notice to the holder or owner of the obligation as is authorized by G.S. 26-7 may be given at or subsequent to the time such obligation is due or at or subsequent to the termination of a period of extension.

(c) The failure of any co-surety, co-indorser or co-guarantor to join in or adopt a notice to the holder or owner of the obligation as authorized by subsection (b) of G.S. 26-7 does not prevent such co-surety, co-indorser or co-guarantor from giving a separate notice as authorized by subsection (a) of G.S. 26-7. (1868-9, c. 232, s. 2; Code, s. 2098; Rev., s. 2847; C.S., s. 3969; 1951, c. 763, s. 3.)

CASE NOTES

Extension of Time. — Where a creditor enters into a binding contract with his principal debtor for an extension of time, without consent of sureties, this ipso facto discharges them, and also any security given for the debt. Hinton v. Greenleaf, 113 N.C. 6, 18 S.E. 56 (1893); Smith v. Building & Loan Ass'n, 119 N.C. 257, 26 S.E. 40 (1896); Jenkins v. Daniel, 125 N.C. 161, 34 S.E. 239, 74 Am. St. R. 632 (1899); Flemming v. Bordon, 127 N.C. 214, 37 S.E. 219, 53 L.R.A. 316 (1900).

Receipt of interest in advance is prima facie evidence of a binding contract of forbearance. Hollingsworth v. Tomlinson, 108 N.C. 245, 12 S.E. 989 (1891); Scott v. Fisher, 110 N.C. 311, 14 S.E. 799, 28 Am. St. R. 688 (1892); Smith v. Parker, 131 N.C. 470, 42 S.E. 910 (1902).

Where a plaintiff creditor made a parol contract with principal to extend the time of payment of bond beyond the date of the commencement of a suit thereon, without the knowledge or consent of the surety, it was held that such contract had the effect of suspending the plaintiff's right of action and of exonerating the surety from liability. Carrier v. Duncan, 84 N.C. 676 (1881).

An agreement with a principal on a sufficient consideration to forbear to sue for a fixed period, without reserving the right to proceed against the surety, made without his assent, will exonerate him from liability. The exoneration grows out of the agreement to forbear and is not affected by the creditor's breach of it. Forbes v. Sheppard, 98 N.C. 111, 3 S.E. 817 (1887).

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by G.S. 26-7 through this section. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with G.S. 26-7. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installation payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under G.S. 26-7 through this section, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Applied in Colonial Acceptance Corp. v. Northeastern Printcrafters, Inc., 75 N.C. App. 177, 330 S.E.2d 76 (1985).

Cited in Community Bank & Trust Co. v. Copses, 953 F.2d 133 (4th Cir. 1991); Nat'l Textiles, LLC v. Daugherty, 250 F. Supp. 2d 575, 2003 U.S. Dist. LEXIS 2135 (M.D.N.C. 2003).

§ **26-10:** Repealed by Session Laws 1943, c. 543.

§ 26-11. Cancellation of judgment as to surety.

Whenever a judgment shall be rendered in any court in accordance with the provisions of G.S. 26-1 and the surety, endorser or other person shown in said judgment to be secondarily liable thereon and having the rights as by this chapter prescribed against the person or persons primarily liable, and the surety, endorser or other person so shown in the judgment to be secondarily liable, shall pay the said judgment or shall be compelled to pay an execution issued thereon and such fact shall appear to the satisfaction of the clerk of the superior court of the county in which the said judgment is rendered and docketed, such judgment shall be canceled as to said surety, endorser or other person secondarily liable and shall ceased to be a lien upon his real estate and other property, but such cancellation shall not have the force and effect nor operate as a cancellation and discharge of the judgment as to any other person against whom the said judgment shall be rendered and the person so paying the said judgment shall have all the rights given to a surety who has been compelled to pay a judgment against the principal debtor and co-sureties which are given in this chapter, notwithstanding the cancellation of the said judgment as herein provided for. (1925, c. 38.)

§ 26-12. Joinder of debtor by surety.

(a) As used in this section, "surety" includes guarantors, accommodation makers, accommodation indorsers, or others who undertake liability on the obligation and for the accommodation of another.

(b) When any surety is sued by the holder of the obligation, the court, on motion of the surety may join the principal as an additional party defendant, provided the principal is found to be or can be made subject to the jurisdiction of the court. Upon such joinder the surety shall have all rights, defenses, counterclaims, and setoffs which would have been available to him if the principal and surety had been originally sued together. (1959, c. 1121.)

CASE NOTES

Defendant guarantors could not avail themselves of the rights and privileges afforded by this section where the principal filed bankruptcy and was subject to the exclusive jurisdiction of the United States District Court for the Western District of North Carolina; the statute expressly states that the principal must be joined as a party and to do so requires the surety to show that the state courts have jurisdiction over the principal. Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Cited in Resolution Trust Corp. v. Southwest Dev. Co., 837 F. Supp. 122 (E.D.N.C. 1992); Poughkeepsie Sav. Bank v. Harris, 833 F. Supp. 551 (W.D.N.C. 1993).

Chapter 27.

Warehouse Receipts.

Article 1.

General Provisions.

Sec.
27-1 through 27-4. [Repealed.]

Article 2.

Issue of Warehouse Receipts.

27-5 through 27-11. [Repealed.]

Article 3.

Obligations and Rights of Warehousemen on Receipts.

27-12 through 27-40. [Repealed.]

Article 4.

Negotiation and Transfer of Receipts.

Sec.
27-41 through 27-53. [Repealed.]

Article 5.

Criminal Offenses.

27-54 through 27-59. [Repealed.]

Cross References. — As to provisions of the UCC relating to warehouse receipts, bills of lading and other documents of title, see G.S. 25-7-101 to 25-7-603.

ARTICLE 1.

General Provisions.

§§ **27-1 through 27-4:** Repealed by Session Laws 1965, c. 700, s. 2.

ARTICLE 2.

Issue of Warehouse Receipts.

§§ **27-5 through 27-11:** Repealed by Session Laws 1965, c. 700, s. 2.

ARTICLE 3.

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§§ **27-12 through 27-40:** Repealed by Session Laws 1965, c. 700, s. 2.

ARTICLE 4.

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§§ **27-41 through 27-53:** Repealed by Session Laws 1965, c. 700, s. 2.

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§§ 27-54 through 27-59: Repealed by Session Laws 2006-112, s. 58(a), effective October 1, 2006.

Editor's Note. — Session Laws 2006-112, s. 58(b), provides: "Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Session Laws 2006-112, s. 60, provides: "A document of title issued or a bailment that arises before the effective date of this act and the rights, obligations, and interests flowing from that document or bailment are governed by any statute amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute."

Chapter 28.

Administration.

§§ 28-1 through 28-201: Repealed by Session Laws 1973, c. 1329, s. 1.

Editor's Note. — Session Laws 1973, c. 1329, repealed this Chapter, enacted a new Chapter 28A, Administration of Decedents' Estates, and redesignated the original Chapter 28A, Estates of Missing Persons, as Chapter 28C. Sections 28-68, 28-68.1, 28-68.2, and 28-68.3 were transferred and renumbered to G.S. 28A-25-6 by the 1973 act. Section 28-53 was transferred and renumbered G.S. 36-67 (repealed, see now G.S. 36A-107) by the 1973 act.

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Editor's Note. — This Chapter was enacted by Session Laws 1973, c. 1329, which repealed former Chapter 28, Administration, and redesignated former Chapter 28A, Estates of Missing Persons, as Chapter 28C. Where appropriate, historical citations to sections in repealed Chapter 28 have been added to similar sections in Chapter 28A.

Session Laws 1973, c. 1329, originally made effective July 1, 1975, was amended by Session Laws 1975, c. 19, s. 12, so as to make it effective as to estates of decedents dying on and after that date, and by Session Laws 1975, c. 118, so as to change the the date to October 1, 1975.

Many of the cases cited under this Chapter were decided under corresponding sections of former Chapter 28.

ARTICLE 1.

Definitions and Other General Provisions.

§ 28A-1-1. Definitions.

As used in this Chapter, unless the context otherwise requires, the term:

(1) "Collector" means any person authorized to take possession, custody, or control of the personal property of the decedent for the purpose of executing the duties outlined in G.S. 28A-11-3.

(1a) "Devisee" means any person entitled to take real or personal property under the provisions of a valid, probated will.

(2) "Foreign personal representative" means a personal representative appointed in another jurisdiction, including a personal representative appointed in another country.
(3) "Heir" means any person entitled to take real or personal property upon intestacy under the provisions of Chapter 29 of the General Statutes.
(4) "Mortgage" includes a deed of trust.
(5) "Personal representative" includes both an executor and an administrator, but does not include a collector.
(6) "Service" means delivery of the citation, summons, notice or other civil process to the person to be served by an officer authorized to serve process and, if such service cannot be obtained, then by the mailing of the citation, summons, notice or other civil process by certified mail, return receipt requested, to the last known address of the person to be served. (1973, c. 1329, s. 3; 1981, c. 955, c. 4.)

Legal Periodicals. — For case law survey on wills and administration, see 41 N.C.L. Rev. 530 (1963).

CASE NOTES

Cited in In re Estate of Bryant, 116 N.C. App. 329, 447 S.E.2d 468 (1994).

§ 28A-1-2: Repealed by Session Laws 1979, c. 88, s. 2.

Cross References. — As to the abolishment of the doctrine of worthier title, see G.S. 41-6.2.

ARTICLE 2.

Jurisdiction for Probate of Wills and Administration of Estates of Decedents.

§ 28A-2-1. Clerk of superior court.

The clerk of superior court of each county, ex officio judge of probate, shall have jurisdiction of the administration, settlement, and distribution of estates of decedents including, but not limited to, the following:

(1) Probate of wills;
(2) Granting of letters testamentary and of administration, or other proper letters of authority for the administration of estates. (R.C., c. 46, s. 1; C.C.P., s. 433; 1868-9, c. 113, s. 115; Code, s. 1374; Rev., s. 16; C.S., s. 1; 1931, c. 165; 1943, c. 543; 1951, c. 765; 1973, c. 1329, s. 3.)

Cross References. — As to suspension, removal and reinstatement of clerk, see G.S. 7A-104. As to clerk's power to remove executors and administrators, see G.S. 28A-9-1. As to probate of wills generally, see G.S. 31-12 et seq.

Legal Periodicals. — For survey of 1976 case law on wills, trusts and estates, see 55 N.C.L. Rev. 1109 (1977).

CASE NOTES

I. General Consideration.
II. Probate of Wills.

III. Letters Testamentary and of Administration.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

History of Clerk's Authority as Judge of Probate. — See In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Jurisdiction Statutory. — The jurisdiction of clerks of court with reference to the administration of estates of deceased persons is altogether statutory, and the clerk's special probate jurisdiction is separate and distinct from his general duties and jurisdiction as clerk. In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Jurisdiction Distinct and Separate from General Duties. — Under this section the duties of the probate judge devolve upon the clerk of the superior court, and in such case he has a special jurisdiction which is distinct and separate from his general duties as clerk. Brittain v. Mull, 91 N.C. 498 (1884); Helms v. Austin, 116 N.C. 751, 21 S.E. 556 (1895).

Jurisdiction Exclusive. — Jurisdiction to appoint an administrator of a deceased person, who has died intestate, and to issue letters for the administration of his estate is conferred by this section exclusively upon the clerk of the superior court of the county in which decedent was domiciled at or immediately previous to his death. Central Bank & Trust Co. v. Board of Comm'rs, 195 N.C. 678, 143 S.E. 252 (1928).

This section confers upon the clerk of the superior court exclusive and original jurisdiction of proceedings for the probate of wills. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950); Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956).

Sections 28A-2-1 through 28A-2-3, as did the former law, vest in the clerk of superior court exclusive jurisdiction of the probate of wills, administration, settlement and distribution of the decedents' estates, the granting of letters, testamentary and of administration, or other letters of authority. Unlike the former law, the jurisdiction of the clerk is no longer limited by such considerations as where the decedent died, left property or was domiciled. Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976).

Except for situations in which the clerk is disqualified to act, G.S. 28A-2-3, the clerk's probate jurisdiction is original and exclusive, and a superior court judge may hear such cases only upon appeal from the clerk. Beck v. Beck, 36 N.C. App. 774, 245 S.E.2d 199 (1978).

In this State, the clerk is given exclusive original jurisdiction of the administration, settlement and distribution of estates except in cases where the clerk is disqualified to act. In re Estate of Snipes, 45 N.C. App. 79, 262 S.E.2d 292 (1980).

Although G.S. 7A-241 provides that exclusive original jurisdiction in probate matters is vested in the "superior court division," this section specifies that the clerk is given exclusive original jurisdiction in the administration of decedents' estates except in cases where the clerk is disqualified to act. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

And Not Affected by Loss or Destruction of Will Before Probate. — The clerk of the superior court has exclusive original jurisdiction to take proofs of wills of persons dying domiciled within his county, and the jurisdiction of the clerk to take proof of a particular will is not affected by its loss or destruction before probate. Anderson v. Atkinson, 234 N.C. 271, 66 S.E.2d 886 (1951). See Anderson v. Atkinson, 235 N.C. 300, 69 S.E.2d 603 (1952); In re Will of Wood, 240 N.C. 134, 81 S.E.2d 127 (1954).

Nor by Later Discovery of Another Document. — Where the clerk of a county had authority, upon proper application and proof, to admit a document to probate as a will, through the exercise of such authority by the admission of the documents to probate, his jurisdiction over the estate becomes exclusive. The subsequent discovery and presentation for probate of another document, executed later, as the last will of the decedent, would not deprive that clerk of the exclusive jurisdiction previously so acquired. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

Exclusive Jurisdiction to Appoint Administrators Lies with Clerk of Superior Court. — A superior court judge lacks jurisdiction to appoint an administrator, because the original and exclusive jurisdiction to appoint administrators lies with the clerk of superior court. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 323 N.C. 171, 373 S.E.2d 104 (1988).

Dispute Over Settlement Agreement Not An Estate Matter. — When petitioner on appeal from an order of the clerk of superior court attacked a prior court decision, there was no merit to her claim that the prior decision was void for lack of subject matter jurisdiction; the trial court had not been addressing an estate matter under G.S. 28A-2-1 but determining whether there were issues of fact about the terms of a settlement agreement following a mediation; it had jurisdiction under G.S. 7A-240 to do this, as it later had jurisdiction to enforce a settlement agreement reached by the parties. In re Estate of Whitaker, 179 N.C. App. 375, 633 S.E.2d 849, 2006 N.C. App. LEXIS 1902 (2006).

Powers and Jurisdiction of Independent Tribunal. — The powers and jurisdiction exercised by the clerk pursuant to this section are not those of a servant or ministerial officer or exercised as and for the superior court, but those of an independent tribunal of original jurisdiction. Edwards v. Cobb, 95 N.C. 4 (1886), followed in In re Styers' Estate, 202 N.C. 715, 164 S.E. 123 (1932).

The clerk acts not as the servant or ministerial officer of the superior court or as and for the court, but as an independent tribunal of original jurisdiction. Edwards v. Cobb, 95 N.C. 4 (1886).

The clerk of the superior court is an independent tribunal of original jurisdiction in the exercise of his probate jurisdiction. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

The authority to probate a will is vested in the clerk of the superior court, and in the exercise of his probate jurisdiction, the clerk is an independent tribunal of original jurisdiction. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Action of Clerk Stands as That of Court. — The exercise of judicial powers by the "clerk of the court" is the exercise of them by the "court" through the clerk; and the action of the clerk stands as that of the court, if not excepted to and reversed or modified on appeal. Brittain v. Mull, 91 N.C. 498 (1884).

Jurisdiction over Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against defendant's based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Summary Proceedings. — The proceedings of the clerk in respect to the exercise of his probate jurisdiction are summary in their nature. Edwards v. Cobb, 95 N.C. 4 (1886).

The word "jurisdiction" in this section is used in the sense of assigning original authority to the clerk. In re Estate of Adamee, 28 N.C. App. 229, 221 S.E.2d 370, rev'd on other grounds, 291 N.C. 386, 230 S.E.2d 541 (1976).

And was not intended to change vesting of concurrent jurisdiction in clerk and superior court under § 7A-241. In re Estate of Adamee, 28 N.C. App. 229, 221 S.E.2d 370, rev'd on other grounds, 291 N.C. 386, 230 S.E.2d 541 (1976).

Derivative Jurisdiction of Judge. — In most instances the superior court judge's probate jurisdiction is, in effect, that of an appellate court, because his jurisdiction is derivative and not concurrent. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Allocation of Jurisdiction Between Clerk and Judge. — Section 7A-241 does not say that concurrent jurisdiction in probate matters is vested in the clerk and the judge of the superior court. It says that probate jurisdiction is vested in the superior court division to be exercised by the superior court and the clerk according to the practice and procedure provided by law. The law, that is, the statutes specifying this practice and procedure, has allocated the jurisdiction between the clerk and the judge. By this section the clerk is given exclusive original jurisdiction of "the administration, settlement and distribution of estates of decedents" except in cases where the clerk is disqualified to act under G.S. 28A-2-3. When the clerk is disqualified to exercise his jurisdiction, the judge has equal authority to perform the clerk's probate duties and, in that sense, he exercises concurrent jurisdiction of probate matters. In all other instances, however, the judge's probate jurisdiction is, in effect, that of an appellate court pursuant to G.S. 7A-251. In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976).

Section 7A-241 Supports Assignment of Original Authority. — The assignment of original authority of probate matters to the clerk in this section is supported by, and not contravened by, G.S. 7A-241. In re Estate of Adamee, 28 N.C. App. 229, 221 S.E.2d 370, rev'd on other grounds, 291 N.C. 386, 230 S.E.2d 541 (1976).

Section 1-276 [see now § 1-301.1 et seq.] Inapplicable on Appeal to Superior Court. — Upon appeal from action taken by the clerk of the superior court, in the exercise of his probate jurisdiction, the jurisdiction of the superior court is derivative, and the provisions of G.S. 1-276 [see now G.S. 1-301.1 et seq.] are not applicable. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Procedure on Appeal from Order of Clerk. — In an appeal from an order of the clerk in a probate matter, the superior court is not required to conduct a de novo hearing. Rather, when a finding of fact by the clerk of court is properly challenged by specific exception, the superior court judge will review those findings, and either affirm, reverse, or modify them. If he deems it advisable, he may submit the issue to a jury, which course he could not follow without hearing evidence. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Action for Breach of Duties, Negligence, and Fraud in Administration of Estate. — In plaintiff's action to recover for breach of fiduciary duties, negligence, and fraud arising from administration of her husband's estate and a trust created under his will, dismissal for want of subject matter jurisdiction on the ground that the claims alleged should be brought initially before the clerk was improper, since the claims were "justiciable matters of a civil nature," original general jurisdiction over which was vested in the trial division, and though the claims arose from administration of an estate, their resolution was not a part of the administration, settlement, or distribution thereof so as to make jurisdiction properly exercisable initially by the clerk; moreover, inclusion by plaintiff in her complaint of matters of which should have been brought initially before the clerk did not require dismissal for want of subject matter jurisdiction of the entire action. Ingle v. Allen, 53 N.C. App. 627, 281 S.E.2d 406 (1981); Ingle v. Allen, 69 N.C. App. 192, 317 S.E.2d 1, cert. denied, 311 N.C. 757, 321 S.E.2d 135 (1984); Ingle v. Allen, 69 N.C. App. 192, 317 S.E.2d 1, cert. denied, 311 N.C. 757, 321 S.E.2d 135 (1984).

Applied in In re Estate of Hodgin, 133 N.C. App. 650, 516 S.E.2d 174 (1999).

Cited in State ex rel. Pilard v. Berninger, 154 N.C. App. 45, 571 S.E.2d 836, 2002 N.C. App. LEXIS 1407 (2002), cert. denied, 356 N.C. 694, 579 S.E.2d 100 (2003).

II. PROBATE OF WILLS.

Original Jurisdiction Vested in Clerk. — Original jurisdiction of proceedings to probate a will is vested in the clerk. In re Will of Belvin, 261 N.C. 275, 134 S.E.2d 225 (1964).

Probate May Not Be Denied on Ground Involving Construction. — The clerk has no right to exclude any part of a will from probate on any ground which involves the construction of the will where testamentary intent is disclosed. Ravenel v. Shipman, 271 N.C. 193, 155 S.E.2d 484 (1967).

Existence of Will Cannot Be Determined in Ordinary Civil Action. — The issue of whether an unprobated script is, or is not, a man's last will cannot be properly brought before the superior court for determination in an ordinary civil action. Anderson v. Atkinson, 234 N.C. 271, 66 S.E.2d 886 (1951). See Anderson v. Atkinson, 235 N.C. 300, 69 S.E.2d 603 (1952).

Unless Answer Denies Averment That Script Offered Is Decedent's Will. — Where the respondents filed answer denying the petitioner's averment that the script offered for probate was the last will and testament of the decedent, such denial raised an issue of devisavit vel non and necessitated transfer of the cause to the civil issue docket for trial by jury, in accordance with G.S. 1-273 [see now G.S. 1-301.1 et seq.]. This being so, jurisdiction to determine the whole matter in controversy, as well as the issue of devisavit vel non, passed to the superior court in term by authority of G.S. 1-276 [see now G.S. 1-301.1 et seq.]. In re Will of Wood, 240 N.C. 134, 81 S.E.2d 127 (1954).

Dissent to Will. — The right, time and manner, and effect of the filing and recording of a dissent to a will are all matters within the probate jurisdiction of the clerk. In re Estate of Snipes, 45 N.C. App. 79, 262 S.E.2d 292 (1980).

Exclusive original jurisdiction to determine the validity of a dissent by a surviving spouse to a will of a deceased spouse lies with the clerk of superior court. Greene v. Lynch, 51 N.C. App. 665, 277 S.E.2d 454 (1981).

Power to Set Aside Probate. — The clerk of the superior court has the power to set aside a probate of a will in common form in a proper case. This power can be exercised by the clerk where it is clearly made to appear that the adjudication and orders have been improvidently granted or that the court was imposed upon or misled as to the essential and true conditions existent in a given case. However, this power of the clerk does not extend to the setting aside of the probate of a will in common form upon grounds which should be raised by caveat. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Procedure Where Jurisdictional Requirements Lacking. — When jurisdictional requirements for probate are shown to be lacking, the clerk may revoke his order admitting the document to probate. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

Motion to Set Aside Probate. — Since the clerk of the superior court of each county has original and exclusive jurisdiction of proceedings to probate a will, he is the tribunal to which a motion is properly made to set aside the probate of a purported will — or part thereof — for any inherent and fatal defect appearing upon the face of the instrument. Ravenel v. Shipman, 271 N.C. 193, 155 S.E.2d 484 (1967).

Clerk May Vacate Order Admitting Will to Probate. — The clerk of the superior court, in his probate jurisdiction, has the power to vacate a previous order admitting a will to probate in common form on motion aptly made, when it is clearly made to appear that the order of probate was improvidently granted, or that the court had been imposed upon and misled as to the essential and true conditions of the case.

In re Smith's Will, 218 N.C. 161, 10 S.E.2d 676 (1940).

The burden of proof on a motion to vacate a probate is on the movants to establish sufficient grounds to set aside the probate. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

III. LETTERS TESTAMENTARY AND OF ADMINISTRATION.

Jurisdiction Invoked by Petition. — The jurisdiction of the clerk as probate judge is invoked by petition disclosing the requisite jurisdictional facts filed by some person entitled to qualify as executor or administrator. In re Estate of Pitchi, 231 N.C. 485, 57 S.E.2d 649 (1950).

When Jurisdiction Presumed. — Where it is admitted that the plaintiff was regularly appointed administrator, it will be presumed that the clerk acted within his jurisdiction. Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905).

Authority to Appoint Administrator Is Limited. — See In re Scarborough, 261 N.C. 565, 135 S.E.2d 529 (1964).

More Than One Appointment. — When letters of administration are once issued to a person who qualified, the powers of the clerk in that respect are exhausted and the subsequent appointment of another person, before the first appointment is revoked, is void. In re Bowman's Estate, 121 N.C. 373, 28 S.E. 404 (1897).

The burden of proof to show jurisdictional facts rests upon the person applying for letters. Reynolds v. Lloyd Cotton Mills, 177 N.C. 412, 99 S.E. 240 (1919).

May Adjudge Person Dead After Absence for Seven Years. — While the death of intestate must be established as a jurisdictional fact to empower the clerk of the superior court to issue letters of administration, the clerk may, upon evidence that a person has been absent from his domicile for seven years without being heard from by those who would be expected to hear from him, if living, adjudge that such person is dead and appoint an administrator of his estate. Carter v. Lilley, 227 N.C. 435, 42 S.E.2d 610 (1947).

Amendment to Substitute Proper Party Relates Back. — Under G.S. 1A-1, Rule 15(a) and (c) and G.S. 1A-1, Rule 17(a), a lack of letters of administration may be cured, and an objection to want of capacity to sue may be avoided by amendment or by substitution of the proper party at any time before hearing. Later appointments of this nature will relate back and validate the proceedings from the beginning regardless of the statute of limitations. McNamara v. Kerr-McGee Chem. Corp., 328 F. Supp. 1058 (E.D.N.C. 1971).

Where a complaint to recover damages under a state wrongful death act was timely filed by an ancillary administrator appointed by a state court without jurisdiction to do so, the complaint could be amended under G.S. 1A-1, Rule 17(a) at a time when a new suit would be barred so as to allege the subsequent effective appointment of the same person as ancillary administrator by a state court having jurisdiction. McNamara v. Kerr-McGee Chem. Corp., 328 F. Supp. 1058 (E.D.N.C. 1971).

Petition for Authority to Operate Estate's Farm. — Although the clerks of the superior courts have no equity jurisdiction, they are given probate jurisdiction by this section, and in the exercise of their probate jurisdiction they may hear and rule on a petition of an executor for authorization to operate the estate's farms to preserve the property pending the determination of caveat proceedings. C.L. Hardy & Co. v. Turnage, 204 N.C. 538, 168 S.E. 823 (1933).

Removal of Executors and Administrators. — The clerks of superior courts have jurisdiction of proceedings for the removal of executors and administrators. Edwards v. Cobb, 95 N.C. 4 (1886).

Direct Attack on Validity of Appointment. — The validity of the appointment of an administrator may not be collaterally attacked in an action against such administrator, but may be directly attacked by any person in interest, including an administratrix of the decedent appointed in another state, by motion before the clerk of the superior court who made the appointment to vacate and set aside the letters of administration theretofore issued by such clerk. King v. Snyder, 269 N.C. 148, 152 S.E.2d 92 (1967).

Collateral Attack. — When the clerk under this section has general jurisdiction of the subject matter of the inquiry, a decree appointing an executor or administrator may not be collaterally attacked. Fann v. North Carolina R.R., 155 N.C. 136, 71 S.E. 81 (1911); Batchelor v. Overton, 158 N.C. 395, 74 S.E. 20 (1912); Tyer v. J.B. Blades Lumber Co., 188 N.C. 268, 124 S.E. 305 (1924). See Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905).

Where jurisdictional facts are lacking, a decree appointing an executor or administrator can be collaterally attacked. Reynolds v. Lloyd Cotton Mills, 177 N.C. 412, 99 S.E. 240 (1919). See Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905).

The facts very generally recognized as jurisdictional are stated in this section, and where, on application for letters of administration, these facts appear of record, the question of the qualification of the appointee cannot be collaterally assailed. Wharton v. New York Life Ins. Co., 178 N.C. 135, 100 S.E. 266 (1919).

The only exception to the rule that the question of the qualification of the appointee cannot be collaterally assailed where facts very generally recognized as jurisdictional appear of record is that it may be shown collaterally that the person for whom an administrator has been appointed is not in fact dead, but is still living. Hines v. Foundation Co., 196 N.C. 322, 145 S.E. 612 (1928).

Where the person for whom an administrator has been appointed is not in fact dead, but is still living, the order making the appointment is void, and it may be attacked collaterally. Holmes v. Wharton, 194 N.C. 470, 140 S.E. 93 (1927), citing Clark v. Carolina Homes, 189 N.C. 703, 128 S.E. 20 (1925).

A clerk has jurisdiction to appoint an administrator where the affidavit of the applicant presumes the death of the decedent from his absence of seven years and the lack of communication from him. The order and appointment can only be avoided by showing the person not to be in fact dead. Chamblee v. Security Nat'l Bank, 211 N.C. 48, 188 S.E. 632 (1936).

Administrator Defending Wrongful Death Action Estopped to Deny Validity of Appointment. — An administrator appointed in this State who undertakes to defend an action for wrongful death by moving to set aside a default judgment and filing answer is thereafter estopped to deny the validity of his own appointment, and the court correctly denies his motion to dismiss the action for lack of jurisdiction of his person or the estate. The validity of his appointment is not before the court, and it is error for the court to find facts in regard thereto. King v. Snyder, 269 N.C. 148, 152 S.E.2d 92 (1967).

§ 28A-2-2. Assistant clerk of superior court.

An assistant clerk of superior court shall have jurisdiction as provided by G.S. 7A-102. (1973, c. 1329, s. 3.)

§ 28A-2-3. Jurisdiction where clerk interested.

Whenever the clerk of superior court is a subscribing witness to a will offered for probate in his county or has an interest, direct or indirect, in an estate or trust within his jurisdiction, jurisdiction with respect thereto shall be vested in the senior resident superior court judge of his district, and shall extend to all things which the clerk of superior court might have done in the administration of such estate. (R.C., c. 46, s. 1; C.C.P., s. 433; 1868-9, c. 113, s. 115; Code, s. 1374; Rev., s. 16; C.S., s. 1; 1931, c. 165; 1943, c. 543; 1951, c. 765; 1973, c. 1329, s. 3; 1975, c. 300, s. 1.)

CASE NOTES

Applied in Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988).

Cited in In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976); Beck v. Beck, 36 N.C. App. 774, 245 S.E.2d 199 (1978).

Article 3.

Venue for Probate of Wills and Administration of Estates of Decedents.

§ 28A-3-1. Proper county.

The venue for the probate of a will and for all proceedings relating to the administration of the estate of a decedent shall be:

(1) In the county in this State where the decedent had his domicile at the time of his death; or

(2) If the decedent had no domicile in this State at the time of death, then in any county wherein the decedent left any property or assets or into which any property or assets belonging to this estate may have come. If there be more than one such county, that county in which proceedings are first commenced shall have priority of venue; or

(3) If the decedent was a nonresident motorist who died in the State, then in any county in the State. (R.C., c. 46, s. 1; C.C.P., s. 433; 1868-9, c. 113, s. 115; Code, s. 1374; Rev., s. 16; C.S., s. 1; 1931, c. 165; 1943, c. 543; 1951, c. 765; 1973, c. 1329, s. 3.)

CASE NOTES

I. General Consideration.
II. Domicile in State.
III. No Domicile in State.

I. GENERAL CONSIDERATION.

Editor's Note. *— Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Citizenship of Beneficiaries Controls in Diversity Action. — In determining the presence of diversity of citizenship when state law requires that an action be prosecuted in the name of a resident administrator, the citizenship of the beneficiaries, rather than that of the administrator, is relevant. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

Venue of a proceeding in the nature of a creditor's supplemental proceeding under G.S. 1-307, in which in order to issue an execution on defendant's interest under his father's will, the trial judge was required to find only that defendant possessed some interest under his father's will, was governed by G.S. 1-307, and not by this section. North Carolina Nat'l Bank v. C.P. Robinson Co., 319 N.C. 63, 352 S.E.2d 684 (1987).

Applied in Locklear v. Nixon, 129 N.C. App. 105, 497 S.E.2d 310 (1998).

Cited in In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976).

II. DOMICILE IN STATE.

The will of a resident of this State should be probated in the county of his domicile. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Grant in Any Other County Void. — Where decedent had a residence in this State, a grant in any county other than that in which he resided is absolutely void. Johnson v. Corpenning, 39 N.C. 216 (1845).

Domicile at death in county of clerk who undertakes probate is essential to jurisdiction. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

Domicile. — See Reynolds v. Lloyd Cotton Mills, 177 N.C. 412, 99 S.E. 240 (1919), containing an excellent discussion of "domicile" as distinguished from "residence," "inhabiting," etc. See also In re Estate of Cullinan, 259 N.C. 626, 131 S.E.2d 316 (1963).

Change of County Lines. — The county referred to in this section is the county at the time of the death of the decedent, and not the one subsequently formed by a change of county lines. Hannon v. Southern Power Co., 173 N.C. 520, 92 S.E. 353 (1917).

Collateral Attack on Appointment. — An order appointing an administrator cannot be collaterally attacked on grounds that deceased was not domiciled in the county of the clerk. Holmes v. Wharton, 194 N.C. 470, 140 S.E. 93 (1927).

III. NO DOMICILE IN STATE.

Assets Sufficient to Convey Jurisdiction. — If the assets are bona notabilia (chattels or goods of sufficient value to be accounted for), they are sufficient to convey jurisdiction to the clerk. Hyman v. Gaskins, 27 N.C. 267 (1844).

Will of Nonresident May Be Probated Where Property Situated. — When the will of a nonresident dying outside the State disposes of property in the State, the will may be offered for original probate before the clerk of the county in which the property is situated. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

The term "asset" includes intangibles. In re Edmundson, 273 N.C. 92, 159 S.E.2d 509 (1968).

The time and manner of bringing the assets into the jurisdiction are immaterial. Shields v. Union Cent. Life Ins. Co., 119 N.C. 380, 25 S.E. 951 (1896).

Automobile Liability Insurance Policy Is Asset. — A policy of automobile liability insurance issued in the name of the deceased by an insurer qualified to do business in this State or otherwise subject to service of process is an asset so as to support the appointment of an ancillary administrator. In re Edmundson, 273 N.C. 92, 159 S.E.2d 509 (1968).

Cause of Action for Death by Wrongful Act as Sufficient Asset. — Where a nonresident is killed in this State, the cause of action for death by wrongful act is sufficient under this section as a basis for the grant of letters in the county where the injury and death occurred. Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905); Fann v. North Carolina R.R., 155 N.C. 136, 71 S.E. 81 (1911).

Where death occurred as a result of a tort committed in this State, the cause of action given by the statutes of this State was an asset within the meaning of this section. In re Scarborough, 261 N.C. 565, 135 S.E.2d 529 (1964).

Appointment of Administrator Authorized Although Only Asset Is Wrongful Death Claim. — See In re Scarborough, 261 N.C. 565, 135 S.E.2d 529 (1964).

Appointment of Ancillary Administrator. — The fact that a personal representative can obtain a judgment in personam on a cause of action for wrongful death which arose in another state is sufficient to authorize the clerk of the superior court to appoint an ancillary administrator. In re Scarborough, 261 N.C. 565, 135 S.E.2d 529 (1964).

§ 28A-3-2. Proceedings to determine venue.

(a) If proceedings are commenced in more than one county or if upon commencement of a proceeding a question arises as to the proper county of venue, or if for any other reason a delay arises in determining venue, then the matter shall be referred by the clerk of superior court before whom the question arises for a hearing before and determination by the senior resident superior court judge or any judge assigned to hold the superior courts of the district which includes the county where the proceedings were first commenced. The judge shall determine which is the proper county for administration of the estate and stay proceedings in all other counties. He shall make such orders as are necessary to transfer the entire proceedings to the proper county. The clerk of superior court of each county in which proceedings are stayed shall retain a true copy of the entire file and transmit the original to the clerk of superior court of such county as the judge directs.

(b) A proceeding shall be deemed commenced by the offering of a will for probate or by applying for letters of administration as provided by G.S. 28A-6-1 through 28A-6-5 or by applying for letters of collection as provided by G.S. 28A-11-1 through 28A-11-4 and the proceeding first legally commenced shall extend to all of the property or assets of the decedent in this State. (1973, c. 1329, s. 3; 1975, c. 19, s. 7.)

§ 28A-3-3. Procedure after determination of improper appointment.

Where a person has been improperly appointed, and a different person in another county is determined under G.S. 28A-3-2(a) to be the properly appointed personal representative, such improperly appointed personal representative shall surrender to the properly appointed personal representative all assets of the estate under his control. In addition such improperly appointed personal representative shall file an accounting with the clerk of superior court in the proper county according to the form prescribed for collectors by G.S. 28A-11-4. (1973, c. 1329, s. 3.)

§ 28A-3-4. Liability of personal representative appointed in improper county.

When a personal representative has been appointed in an improper county, and a different person in another county is determined under G.S. 28A-3-2(a) to be the properly appointed personal representative, such improperly appointed personal representative shall not thereby incur personal liability for administrative acts performed prior to the transfer except as provided in G.S. 28A-13-10. (1973, c. 1329, s. 3.)

§ 28A-3-5. Waiver of venue.

If questions as to priority of venue are not raised within three months after the issuance of letters testamentary or letters of administration to the personal representative, the validity of the proceeding shall not be affected by any error in venue. (1973, c. 1329, s. 3.)

CASE NOTES

Venue Challenge Precluded. — Caveators who failed to raise objections until over four months after the issuance of testamentary letters were precluded from challenging venue under this section. In re Estate of Hodgin, 133 N.C. App. 650, 516 S.E.2d 174 (1999).

Article 4.

Qualification and Disqualification for Letters Testamentary and Letters of Administration.

§ 28A-4-1. Order of persons qualified to serve.

(a) Letters Testamentary. — Letters testamentary shall be granted to the executor or executors named or designated in the will, or if no such person qualifies, to any substitute or successor executor named or designated in the will. If no person so named or designated qualifies, letters testamentary shall be granted to some other person nominated by a person upon whom the will expressly confers the authority to make such nomination. If none of the foregoing persons qualifies or if the clerk of superior court upon hearing finds that none of the foregoing persons is qualified in accordance with G.S. 28A-4-2, the clerk shall grant letters of administration in accordance with subsection (b).

(b) Letters of Administration. — Letters of administration shall be granted to persons who are qualified to serve, in the following order, unless the clerk of superior court in his discretion determines that the best interests of the estate otherwise require:

(1) The surviving spouse of the decedent;
(2) Any devisee of the testator;
(3) Any heir of the decedent;
(3a) Any next of kin, with a person who is of a closer kinship as computed pursuant to G.S. 104A-1 having priority;
(4) Any creditor to whom the decedent became obligated prior to his death;
(5) Any person of good character residing in the county who applies therefor; and
(6) Any other person of good character not disqualified under G.S. 28A-4-2.

When applicants are equally entitled, letters shall be granted to the applicant who, in the judgment of the clerk of superior court, is most likely to administer the estate advantageously, or they may be granted to any two or more of such applicants. (R.C., c. 46, ss. 2, 3; C.C.P., s. 456; 1968-9, c. 113, s. 115; Code, s. 1376; Rev., s. 3; C.S., s. 6; 1949, c. 22; 1973, c. 1329, s. 3; 1987, c. 357.)

Cross References. — As to public administrator, see G.S. 28A-12-4. As to who may act in the event the executor fails to apply to have the will proved, see G.S. 31-13.

CASE NOTES

I. General Consideration.
II. Letters Testamentary.
III. Letters of Administration.

I. GENERAL CONSIDERATION.

Editor's Note. *— Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Applied in In re Estate of Bryant, 116 N.C. App. 329, 447 S.E.2d 468 (1994).

Cited in Baer v. Davis, 47 N.C. App. 581, 267 S.E.2d 581 (1980); Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

II. LETTERS TESTAMENTARY.

No conflict of interest is created by mere fact that executor also occupies status of creditor. Tyson v. North Carolina Nat'l Bank, 53 N.C. App. 189, 280 S.E.2d 478 (1981), modified, 305 N.C. 136, 286 S.E.2d 561 (1982).

III. LETTERS OF ADMINISTRATION.

Right to administer on estate of an intestate is entirely statutory. In re Edwards' Estate, 234 N.C. 202, 66 S.E.2d 675 (1951).

Selection Among Persons of Equal Degree. — Where there are several persons entitled in equal degree to administer, the clerk may select the one who, in his discretion, is most fit. Garrison v. Cox, 95 N.C. 353 (1886).

Next of Kin. — As to right to administer of next of kin, under language of former statute, see Carthey v. Webb, 6 N.C. 268 (1813); Moore v. Moore, 12 N.C. 352 (1827); Stoker v. Kendall, 44 N.C. 242 (1853); Atkins v. McCormick, 49 N.C. 274 (1857); Little v. Berry, 94 N.C. 433 (1886); In re Saville, 156 N.C. 172, 72 S.E. 220 (1911); In re Edwards' Estate, 234 N.C. 202, 66 S.E.2d 675 (1951).

For purposes of this section, "next of kin" refers to the class of blood relatives of the decedent; thus, the court erred in determining that the term was synonymous with "heirs," as used in G.S. 41-6.1. In re Estate of Bryant, 116 N.C. App. 329, 447 S.E.2d 468 (1994).

Effect of Appointment Out of Order. — The appointment as administrator of a person other than the one designated by this section is not void, though the proper person has not renounced; but it may be set aside in favor of such proper person provided he has not waived his right to administer. Garrison v. Cox, 95 N.C. 353 (1886).

Correction of Error in Appointment. — Petitioner, an heir at law and beneficiary under will, had a higher preference of appointment than respondent, who was neither an heir nor a beneficiary, and as the respondent should not have been appointed administrator C.T.A. without notice to the petitioner, it was not error for the clerk to correct this error by removing the respondent as administrator C.T.A. The fact that petitioner may not have been qualified to serve as administrator C.T.A. under G.S. 28A-4-2(4) because she was a nonresident of this State who had not appointed a process agent was irrelevant. In re Estate of Cole, 80 N.C. App. 720, 343 S.E.2d 263 (1986).

Estoppel Against Widow. — Though the widow has a prior right to administration over a brother of the decedent, where it appears that at the time the letters were duly granted to the brother she had shown no disposition to set up her right before the clerk, the appointment of the brother will stand. Tyer v. J.B. Blades Lumber Co., 188 N.C. 268, 124 S.E. 305 (1924).

Assignee After Death Not a Creditor. — An assignment of debts of a person after his death does not make the assignee such a creditor as to entitle him to administer the estate of the deceased. Pearce v. Castrix, 53 N.C. 71 (1860).

Where a husband and wife enter into a separation agreement and thereafter become reconciled and renew their marital relations, the agreement is rescinded for every purpose, including the wife's right to share in husband's estate and her right to administer the estate, insofar as it remains executory. In re Estate of Adamee, 28 N.C. App. 229, 221 S.E.2d 370, rev'd on other grounds, 291 N.C. 386, 230 S.E.2d 541 (1976).

Possessor of Insurance Policy. — The possession of a policy of life insurance authorizes the possessor to administer on the estate of the assured, a nonresident. Page v. Life Ins. Co., 131 N.C. 115, 42 S.E. 543 (1902). See Shields v. Union Cent. Life Ins. Co., 119 N.C. 380, 25 S.E. 951 (1896).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

De Novo Hearing on Appeal. — Upon appeal from the order of the clerk of superior court the petitioners were entitled to a de novo hearing by the judge of superior court on both the right of respondent to qualify as administratrix and her right to share in the estate of her deceased husband. And the judge of superior court in the exercise of his inherent powers had the right to submit to the jury the one issue that would resolve both the right to qualify as administratrix, a probate matter, and the right to share in the decedent's estate, which is not a probate matter. In re Estate of Adamee, 28 N.C. App. 229, 221 S.E.2d 370, rev'd on other grounds, 291 N.C. 386, 230 S.E.2d 541 (1976).

§ 28A-4-2. Persons disqualified to serve as personal representative.

No person is qualified to serve as a personal representative who:

(1) Is under 18 years of age;

(2) Has been adjudged incompetent in a formal proceeding and remains under such disability;

(3) Is a convicted felon, under the laws either of the United States or of any state or territory of the United States, or of the District of Columbia and whose citizenship has not been restored;

(4) Is a nonresident of this State who has not appointed a resident agent to accept service of process in all actions or proceedings with respect to the estate, and caused such appointment to be filed with the court; or who is a resident of this State who has, subsequent to appointment as a personal representative, moved from this State without appointing such process agent;

(5) Is a corporation not authorized to act as a personal representative in this State;

(6) Repealed by Session Laws 1999-133, s. 1, effective January 1, 2000.

(7) Has lost his rights as provided by Chapter 31A;

(8) Is illiterate;

(9) Is a person whom the clerk of superior court finds otherwise unsuitable; or

(10) Is a person who has renounced either expressly or by implication as provided in G.S. 28A-5-1 and 28A-5-2. (C.C.P., s. 457; Code, ss. 1377, 1378, 2162; Rev., s. 5; C.S., s. 8; 1973, c. 1329, s. 3; 1999-133, s. 1.)

Cross References. — As to ineligibility of foreign corporation to qualify as executor, administrator, etc., in this State, with certain exceptions, see G.S. 55-15-05.

Legal Periodicals. — For legislative survey of trusts and estates, see 22 Campbell L. Rev. 253 (2000).

CASE NOTES

I. General Consideration.
II. Persons Under 18.
III. Incompetents.
IV. Nonresidents.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Testator has the right to name the person who shall administer his estate after his death, provided his designate is not disqualified by law. In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

Right of Person Named as Executor to Administer Estate. — The person testator names as executor has the right to administer the estate. In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

When Right Ceases. — He can be deprived of that right only by his refusal or neglect to probate the will or to take out letters, or by his inability or unsuitableness to execute the trust. In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

Statutory specifications of disqualifications for service as a personal representative cannot be superseded by the broad general policy of the law which gives effect to the desires of a testator and sees that his intentions are carried out so far as they can be ascertained. In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

Personal Interests Antagonistic to Estate as Grounds for Disqualification. — When it appears that the personal interests of the prospective executor are so antagonistic to the interests of the estate and those entitled to its distribution that the same person cannot fairly represent both, the testator's nominee is unsuitable and disqualified as a matter of law. This is especially true where the conflict is one which the testator did not know or foresee. In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

Right to Nominate Depends upon the Right to Administer. — See Boynton v. Heartt, 158 N.C. 488, 74 S.E. 470 (1912).

Public administrator could not be removed at the instance of nonresidents who had no right of appointment as administrator in consequence of not having the right to administer upon the estate in this State. Boynton v. Heartt, 158 N.C. 488, 74 S.E. 470 (1912).

Correction of Error in Appointment. — Petitioner, an heir at law and beneficiary under will, had a higher preference of appointment than respondent, who was neither an heir nor a beneficiary, and as the respondent should not have been appointed administrator C.T.A. without notice to the petitioner, it was not error for the clerk to correct this error by removing the respondent as administrator C.T.A. The fact that petitioner may not have been qualified to serve as administrator C.T.A. under subdivision (4) of this section because she was a nonresident of this State who had not appointed a process agent was irrelevant. In re Estate of Cole, 80 N.C. App. 720, 343 S.E.2d 263 (1986).

Appointment of Replacement Representative. — The trial court did not abuse its discretion in appointing the public administrator, rather than the testamentary alternative, to finalize the estate after removing the personal representative for misconduct. In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Collateral Attack for Disregard of Statutory Provisions. — When, in disregard of provisions prohibiting the issuance of letters to persons adjudged incompetent, letters were issued to a foreign executor, this was a mere irregularity and could not be collaterally attacked in an action by the executor. Batchelor v. Overton, 158 N.C. 395, 74 S.E. 20 (1912).

Applied in Storey v. Hailey, 114 N.C. App. 173, 441 S.E.2d 602 (1994); In re Estate of Montgomery, 137 N.C. App. 564, 528 S.E.2d 618, 2000 N.C. App. LEXIS 422 (2000).

Cited in Messer v. American Gems, Inc., 612 F.2d 1367 (4th Cir. 1980).

II. PERSONS UNDER 18.

A widow under 21 [now 18] is not eligible to appointment as administratrix. The court may, however, appoint an administrator during her minority and, on arriving at full age, grant her the administration; or it may give the office to her appointee. Wallis v. Wallis, 60 N.C. 78 (1863).

III. INCOMPETENTS.

Finding of Incompetency Based on Undisclosed and Unrecorded Information. — Where the record shows that the conclusion of the clerk as to the alleged incompetency of the petitioner rests upon undisclosed and unrecorded information obtained by the clerk from third persons outside of court in the absence of the petitioner and his counsel, who were not apprised of the identity of such third persons or accorded any opportunity to cross-examine or confute them, the refusal of the clerk to issue letters of administration to the petitioner is error. In re Edwards' Estate, 234 N.C. 202, 66 S.E.2d 675 (1951).

Illiteracy as Incompetency under Former Statute. — See Stephenson v. Stephenson, 49 N.C. 472 (1857).

IV. NONRESIDENTS.

Noncitizen Entitled to Federal Forum. — Diversity jurisdiction exists for the protection of the noncitizen who is obliged to sue or to be sued in the state of his adversary. It is for that reason that state statutes or decisions that require a noncitizen to appoint an in-state representative should not have the effect of depriving the noncitizen of the federal forum that Congress has provided him. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

Citizenship of Beneficiaries Controls in Diversity Action. — In determining the presence of diversity of citizenship when state law requires that an action be prosecuted in the name of a resident administrator, the citizenship of the beneficiaries, rather than that of the administrator, is relevant. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

ARTICLE 5.

Renunciation by Personal Representative.

§ 28A-5-1. Renunciation by executor.

(a) Express Renunciation by Executor. — Any person named or designated as executor in a duly probated will may renounce the office by filing with the clerk of superior court a writing signed by such person, and acknowledged or proved to the satisfaction of the clerk.

(b) Implied Renunciation by Executor. — If any person named or designated as executor fails to qualify or to renounce within 30 days after the will had been admitted to probate, the clerk of superior court, on application of any other person named or designated as executor in the will or of any interested person, shall, or on his own motion may, issue a citation to the person who has failed to qualify or renounce to show cause why he should not be deemed to have renounced. If, upon service of the citation, he does not qualify or renounce or show cause within the time fixed in the citation, such period to be not less than 10 nor more than 30 days, an order must be entered by the clerk of superior court adjudging that he has renounced. If cause be shown, the clerk of superior court may grant to such person a reasonable extension of time within which to qualify or renounce.

(c) Procedure upon Renunciation. — Upon renunciation by a person named or designated as executor, letters shall be issued to some other person as provided in G.S. 28A-4-1. (C.C.P., ss. 450, 451; Code, ss. 2163, 2164; Rev., ss. 10, 13; C.S., ss. 13, 16; 1931, c. 183; 1953, c. 78, s. 1; 1973, c. 1329, s. 3.)

Cross References. — As to powers of surviving personal representative, see G.S. 28A-13-9. As to resignation of trustees and other fiduciaries, see G.S. 36A-22 et seq.

CASE NOTES

Editor's Note. *— Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Common-Law Rule. — See McIntyre v. Proctor, 145 N.C. 288, 59 S.E. 39 (1907). See Washington v. Blunt, 43 N.C. 253 (1852).

Executor may, by permission of the superior court, renounce all right to the executorship and withdraw from a suit. Sawyer v. Dozier, 27 N.C. 97 (1844).

Time of Renunciation. — A court of probate may accept a renunciation at any time before the executor intermeddled with the effects of his testator, even after he has proved the will. The same rule applies to an executor of an executor under a prior will. Mitchell v. Adams, 23 N.C. 298 (1840).

When Leave of Court Required. — After probate an executor cannot renounce at his own pleasure, and must do so by leave of the court. Mitchell v. Adams, 23 N.C. 298 (1840).

Letters Revoked for Cause Only. — The clerk should revoke letters testamentary, where the executor has entered upon performance of his duties, only by reason of some unfitness or unfaithfulness on the part of trustee, and never simply because the parties desire it. McIntyre v. Proctor, 145 N.C. 288, 59 S.E. 39 (1907).

Renunciation Must Appear of Record. — Renunciation of the executor must appear of record to enable the court to appoint an administrator with the will annexed. Springs v. Irwin, 28 N.C. 27 (1845).

Renunciation by Some of Several. — Where there are several persons of the same class entitled to administer, renunciation by some of them does not affect the rights of those not renouncing to administer. In re Jones' Estate, 177 N.C. 337, 98 S.E. 827 (1919).

Retraction of Renunciation. — A renouncing executor may retract his renunciation at any time before administration is granted, and then administer. Any intermeddling with the estate before qualifying is evidence of such retraction. Davis v. Inscoe, 84 N.C. 396 (1881).

Right of Reinstatement. — There are decisions that an executor who has renounced can, under some circumstances, come in and qualify. See Davis v. Inscoe, 84 N.C. 396 (1881); Wood v. Sparks, 18 N.C. 389 (1835). But there is no case in which he has renounced with the formalities of this statute and afterwards has qualified, certainly not after the lapse of 20 years. Ryder v. Oates, 173 N.C. 569, 92 S.E. 508 (1917).

Powers of Administrator c.t.a. — After renunciation by the executor, the administrator with the will annexed is competent to exercise the executor's powers under the will. Saunders v. Saunders, 108 N.C. 327, 12 S.E. 909 (1891).

Cited in In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

§ 28A-5-2. Renunciation of right to administer.

(a) Express Renunciation. — Any person entitled to apply for letters of administration may renounce the office by filing with the clerk of superior court a writing signed by such person, and acknowledged or proved to the satisfaction of the clerk.

(b) Implied Renunciation. —

(1) If any person entitled to apply for letters of administration fails to apply therefor within 30 days from the date of death of the intestate, the clerk of superior court, on application of any interested person, shall, or on his own motion may, issue a citation to the person entitled to apply for letters of administration requiring him to show cause why he should not be deemed to have renounced. If, upon service of the citation, he does not apply for letters of administration and tender the required bond or show cause within the time shown in the citation, such period to be not less than 10 nor more than 30 days, an order must be entered by the clerk of the superior court adjudging that he has renounced; and the clerk of superior court shall issue letters to some other person as provided in G.S. 28A-4-1. If cause be shown the clerk of superior court may grant to such person a reasonable extension of time within which to apply and qualify, or renounce.

(2) If no person entitled to administer applies for letters of administration within 90 days after the date of death of an intestate, then the clerk of superior court may, in his discretion, enter an order declaring all prior rights to apply for letters of administration to be renounced, and issue letters to some suitable person as provided in G.S. 28A-4-1.

(c) Nomination by Person Renouncing. — Any person who expressly renounces his prior right to apply for letters of administration may at the same time nominate in writing some other person not disqualified under G.S. 28A-4-2 to be named as personal representative, and such designated person shall be entitled to the same priority of right to apply for letters of administration as the person making the nomination. (R.C., c. 46, ss. 2, 3; C.C.P., ss. 456, 460(a); 1868-9, c. 113, s. 115; c. 203; Code, ss. 1376, 1380; Rev., ss. 3, 12; C.S., ss. 6, 15; 1949, c. 22; 1973, c. 1329, s. 3.)

Cross References. — As to when a public administrator shall apply for letters, see G.S. 28A-12-4.

CASE NOTES

***Editor's Note.** — Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Applicable to Intestacy Only. — The provisions of this section contemplate cases of intestacy. Hence in cases of testacy where no executor is appointed in the will, the rights of the parties to administer are governed by G.S. 28A-4-1 without reference to the six months' (now 90-day) limitation contained in this section. In re Jones' Estate, 177 N.C. 337, 98 S.E. 827 (1919).

Right to Administer Not Absolute Nor Exclusive. — See Stoker v. Kendall, 44 N.C. 242 (1853).

Means of Quickening Procedure. — The true intent and meaning of this section is that the persons primarily entitled to administration may have six months (now 90 days) after the death of the intestate to assert their rights and comply with the law; and a party wishing to quicken their diligence within that time must do so by citation — he may not, by obtaining letters within six months (now 90 days), deprive the party primarily entitled to administration should such party apply for letters before the expiration of the six months' (now 90-day) period. Williams v. Neville, 108 N.C. 559, 13 S.E. 240 (1891).

Persons primarily entitled to administration shall assert their right and comply with the law within six months (now 90 days) after the death of the intestate, and a party interested, wishing to quicken their diligence within that time, must do so by citation as prescribed by statute, or if a person, not preferred, applied for administration within six months (now 90 days), he must produce the written renunciation of the person or persons having prior right. Royals v. Baggett, 257 N.C. 681, 127 S.E.2d 282 (1962).

Unreasonable Delay. — No one who has precedence in a claim for letters loses such rights by delay merely, but by unreasonable delay, which is a matter of law. Hughes v.

Pipkin, 61 N.C. 4 (1866).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

Renunciation Presumed After 90 Days. — After the expiration of six months (now 90 days) from the death of the decedent, those entitled to prior rights having failed to apply, all rights of preference may be treated as renounced, and a suitable person to administer upon the estate may be appointed. Hill v. Alspaugh, 72 N.C. 402 (1875).

Appointment Within 90 Days. — If the person entitled to apply for letters of administration, in answer to citation, names his appointee, and such person, after appointment, fails to qualify, then, though six months (now 90 days) have to expired, the clerk is authorized to appoint another. Williams v. Neville, 108 N.C. 559, 13 S.E. 240 (1891).

Effect of Appointment. — Where the clerk has appointed an administrator under this section, a debtor of the estate cannot maintain the position that the appointment of a public administrator was necessary to receive payment of the debt. Brooks v. E.H. Clement Co., 201 N.C. 768, 161 S.E. 403 (1931).

Appointment Not Revoked After 90 Days. — If the parties who have precedence to administer fail to apply within six months (now 90 days) from death of the deceased, an appointment by the clerk of a proper person after that period will not be revoked. Withrow v. DePriest, 119 N.C. 541, 26 S.E. 110 (1896).

Failure of Public Administrator to Apply Within Six Months (now 90 Days). — Though it is the duty of the public administrator to apply after six months (now 90 days), if, before his appointment at any time, even after six months (now 90 days), persons prior in rights to administer apply, they are entitled to appointment. In re Bailey's Will, 141 N.C. 193, 53 S.E. 844 (1906).

Cited in Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

ARTICLE 6.

Appointment of Personal Representative.

§ 28A-6-1. Application for letters; grant of letters.

(a) The application for letters of administration or letters testamentary shall be in the form of an affidavit sworn to before an officer authorized to administer oaths, signed by the applicant or his attorney, which may be supported by other proof under oath in writing, all of which shall be recorded and filed by the clerk of superior court, and shall allege the following facts:

(1) The name, and to the extent known, the domicile and the date and place of death of the decedent;
(2) The legal residence and mailing address of the applicant;
(3) The names, ages and mailing addresses of the decedent's heirs and devisees, including the names and mailing addresses of the guardians of those having court-appointed guardians, so far as all of these facts are known or can with reasonable diligence be ascertained;
(4) That the applicant is the person entitled to apply for letters, or that he applies after persons having prior right to apply are shown to have renounced under Article 5 of this Chapter, or that he applies subject to the provisions of G.S. 28A-6-2(1), and that he is not disqualified under G.S. 28A-4-2.
(5) The nature and probable value of the decedent's property, both real and personal, and the location of such property, so far as all of these facts are known or can with reasonable diligence be ascertained; and
(6) If the decedent was not domiciled in this State at the time of his death, a schedule of his property located in this State, and the name and mailing address of his domiciliary personal representative, or if there is none, whether a proceeding to appoint one is pending.

(b) If it appears to the clerk of superior court that the application and supporting evidence comply with the requirements of subsection (a) and on the basis thereof he finds that the applicant is entitled to appointment, he shall issue letters of administration or letters testamentary to the applicant unless in his discretion he determines that the best interests of the estate would be served by delaying the appointment of a personal representative, in which case he may appoint a collector as provided in Article 11. (C.C.P., s. 461; Code, s. 1381; Rev., s. 26; C.S., s. 28; 1973, c. 1329, s. 3.)

CASE NOTES

Appointment Based on Legal Presumption of Death. — Upon an affidavit showing that a person had been absent for over seven years and had not been heard from by relatives or friends, the fact that at the time of the appointment it was contemplated that an action should be brought to determine any question that might arise contrary to the legal presumption of death does not invalidate the appointment or nullify the proof afforded by the jurisdictional affidavit. Chamblee v. Security Nat'l Bank, 211 N.C. 48, 188 S.E. 632 (1936), decided under prior law.

Administration of Living Person's Estate Is Void. — Grant of administration upon the estate of a living man and a decree for the sale of his lands are void for lack of jurisdiction. Springer v. Shavender, 118 N.C. 33, 23 S.E. 976 (1896), decided under prior law.

Disqualification. — Considering the legislative history and the purpose of G.S. 31A-1(a), "living in adultery" means a spouse engages in repeated acts of adultery within a reasonable period of time preceding the death of her spouse; therefore, "living in adultery" requires a showing of something more than "committing adultery," or a single act of adultery, and something less than "residing" in adultery, because the latter construction would permit spouses to engage in habitual adultery with those with whom they do not reside and nevertheless be qualified to administer their decedent spouse's estate under this section. In re Estate of Montgomery, 137 N.C. App. 564, 528 S.E.2d 618, 2000 N.C. App. LEXIS 422 (2000).

§ 28A-6-2. Letters issued without notice; exceptions.

Letters of administration or letters testamentary may be issued without notice, except:

(1) When the applicant is not entitled to priority of appointment under G.S. 28A-4-1, all persons entitled to an equal or higher preference shall be given notice by citation as provided in G.S. 28A-5-2(b)(1), unless they have renounced in accordance with the provisions of Article 5 of this Chapter.

(2) The clerk of superior court may in any case require that notice be given to such interested persons as he in his discretion may designate prior to the granting of letters. (1973, c. 1329, s. 3.)

CASE NOTES

Correction of Error in Appointment. — Petitioner, an heir at law and beneficiary under will, had a higher preference of appointment than respondent, who was neither an heir nor a beneficiary, and as the respondent should not have been appointed administrator C.T.A. without notice to the petitioner, it was not error for the clerk to correct this error by removing the respondent as administrator C.T.A. The fact that petitioner may not have been qualified to serve as administrator C.T.A. under G.S. 28A-4-2(4) because she was a nonresident of this State who had not appointed a process agent was irrelevant. In re Estate of Cole, 80 N.C. App. 720, 343 S.E.2d 263 (1986).

§ 28A-6-3. Appointment of successor to personal representative.

When the appointment of a sole or last surviving personal representative is terminated by death, resignation pursuant to Article 10 of this Chapter, or revocation pursuant to Article 9 of this Chapter, the clerk of superior court shall appoint another personal representative as provided by G.S. 28A-4-1 to act as his successor. When two or more personal representatives have qualified, and the appointment of one or more of them is terminated by death, resignation or revocation, leaving in office one or more personal representatives, the appointment of successors shall not be required unless:

(1) The clerk of superior court determines, in his discretion, that it is in the best interest of the estate to appoint a successor or successors to such personal representative or personal representatives, or

(2) In the case of executors, the will so provides. (1868-9, c. 113, s. 92; Code, s. 1521; Rev., s. 35; C.S., s. 32; 1973, c. 1329, s. 3.)

CASE NOTES

Clerk is required to immediately appoint some person to succeed in the administration of the estate, and it is immaterial so far as continuity of the succession is concerned whether the successor be administrator d.b.n., executor, administrator c.t.a., administrator c.t.a., d.b.n., or collector. Harrison v. Carter, 226 N.C. 36, 36 S.E.2d 700, 164 A.L.R. 697 (1946), decided under prior law.

Successor Cannot Be Appointed Until Vacancy Exists. — Since a person to whom letters testamentary have been issued has authority to represent the estate until his death, resignation or until he has been removed or the letters testamentary have been revoked in accordance with statutory procedure, the appointment by the clerk of an administrator c.t.a., d.b.n., upon petition of the residuary legatee alleging failure of the executor to account to the estate for rents and profits, is void, the clerk being without jurisdiction to make the appointment. Edwards v. McLawhorn, 218 N.C. 543, 11 S.E.2d 562 (1940), decided under prior law.

§ 28A-6-4. Right to contest appointment; procedure.

Prior to the issuance of letters, any interested person may, by written objection filed with the clerk of superior court, with notice to the applicant, contest the issuance of letters of administration or letters testamentary to such applicant. After an objection has been duly filed, the clerk of superior court shall conduct a hearing and determine whether letters shall issue to the applicant. Appeal may be taken from the order of the clerk as in a special proceeding. (C.C.P., s. 462; Code, s. 1382; Rev., s. 27; C.S., s. 29; 1973, c. 1329, s. 3; 1975, c. 300, s. 2.)

Cross References. — As to the running of the statute of limitations when there is contest, see G.S. 1-24.

CASE NOTES

Right of interested persons to contest appointment of decedent's personal representative and the procedure for doing so under the former law, G.S. 28-30 and 28-32, remains substantially unchanged under the present law. In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976), decided under prior law.

Title of Property Not Question of Fact. — A dispute as to the title of property of the decedent is not such an issue of fact as is contemplated by this section. In re Tapp's Estate, 114 N.C. 248, 19 S.E. 150 (1894), decided under prior law.

Collateral Attack after Letters Issued. — Once the letters are issued and appointment made, they cannot be collaterally attacked. Thus, in an action by the administrator against defendant for damages for killing the decedent negligently, the legality of his appointment on the ground of residence cannot be raised. Fann v. North Carolina R.R., 155 N.C. 136, 71 S.E. 81 (1911); Batchelor v. Overton, 158 N.C. 395, 74 S.E. 20 (1912), decided under prior law.

§ 28A-6-5. Letters not subject to collateral attack.

The validity of letters issued shall not be subject to collateral attack. (1973, c. 1329, s. 3.)

CASE NOTES

Once letters are issued and appointment made, they cannot be collaterally attacked. Thus, in an action by the administrator against defendant for damages for killing the decedent negligently, the legality of his appointment on the ground of residence cannot be raised. Fann v. North Carolina R.R., 155 N.C. 136, 71 S.E. 81 (1911); Batchelor v. Overton, 158 N.C. 395, 74 S.E. 20 (1912), decided under prior law.

ARTICLE 7.

Oath.

§ 28A-7-1. Oath required before letters issue.

Before letters testamentary, letters of administration or letters of collection are issued to any person, he shall take and subscribe an oath or affirmation before the clerk of superior court, or before any other officer of any state or country authorized by the laws of North Carolina to administer oaths, that he will faithfully and honestly discharge the duties of his office. Such oath or affirmation shall be in the form prescribed in G.S. 11-11, and shall be filed in the office of the clerk of superior court. (C.C.P., ss. 467, 468; 1870-1, c. 93; Code, ss. 1387, 1388, 2169; Rev., s. 29; C.S., s. 39; 1923, c. 56; 1967, c. 41, s. 1; 1973, c. 1329, s. 3.)

Cross References. — As to form of oath, see G.S. 11-11.

ARTICLE 8.

Bond.

§ 28A-8-1. Bond required before letters issue; when bond not required.

(a) Except as otherwise provided in subsection (b), every personal representative, before letters are issued, shall give bond, conditioned as provided in G.S. 28A-8-2.

(b) No bond shall be required of:

(1) A resident executor, unless the express terms of the will require him to give bond;

(2) A nonresident executor (or a resident executor who moves from this State subsequent to his appointment) who has appointed a resident agent to accept service of process as provided in G.S. 28A-4-2(a) [28A-4-2(4)], when the express terms of the will excuse him from giving bond;

(3) A nonresident executor, when there is a resident executor named who has qualified as coexecutor unless the express terms of the will require them to give bond, or the clerk of superior court finds that such bond is necessary for the protection of the estate; or

(4) A personal representative appointed solely for the purpose of bringing an action for the wrongful death of the deceased until such time as the

personal representative shall receive property into the estate of the deceased; or

(5) A personal representative that is a national banking association having its principal place of business in this State or a State bank acting pursuant to G.S. 53-159;

(6) A personal representative of an intestate who resides in the State of North Carolina when all of the heirs of the decedent are over 18 years of age and file with the clerk of superior court a written waiver instrument agreeing to relieve the personal representative from the necessity of giving bond; or

(7) A personal representative where he receives all the property of the decedent;

(8) An administrator with the will annexed who resides in the State of North Carolina when all of the devisees of the decedent are over 18 years of age and file with the clerk of superior court a written waiver instrument agreeing to relieve him of the necessity of giving bond. (C.C.P., ss. 467, 468; 1870-1, c. 93; Code, ss. 1387, 1388, 2169; Rev., s. 29; C.S., s. 39; 1923, c. 56; 1967, c. 41, s. 1; 1973, c. 1329, s. 3; 1975, c. 300, s. 3; 1977, c. 29; 1981, c. 428; c. 599, ss. 5, 6.)

§ 28A-8-1.1. Deposited money; exclusion in computing amount of bond.

Notwithstanding the provisions of G.S. 28A-8-1, in any proceeding for the determination of the amount of bond to be required of the personal representative or testamentary trustee, whether at the time of appointment or subsequently, when it appears that the estate of the decedent or the testamentary trust includes money which has been or will be deposited in a bank or banks in this State, or money which has been or will be invested in an account or accounts in an insured savings and loan association or associations upon condition that such money will not be withdrawn except on authorization of the court, the court may, in its discretion, order such money so deposited or so invested and shall exclude such deposited money from the computation of the amount of such bond or reduce the amount of bond to be required in respect of such money to such an amount as it may deem reasonable.

The petitioner for letters testamentary, of administration, or of trusteeship may deliver to any such bank or association any such money in his possession, or may allow such bank to retain any such money already in its possession, or may allow such association to retain any such money already invested with it; and, in either event, the petitioner shall secure and file with the court a written receipt including the agreement of the bank or association that such money shall not be allowed to be withdrawn except on authorization of the court. In so receiving and retaining such money, the bank or association shall be protected to the same extent as though it had received the same from a person to whom letters testamentary, of administration, or of trusteeship had been issued.

The term “account in an insured savings and loan association” as used in this section means an account insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation or by a mutual deposit guaranty association authorized by Article 7A of Chapter 54 of the General Statutes of North Carolina.

The term “money” as used in this section means the principal of the decedent’s estate and does not include the income earned by the principal of the decedent’s estate which may be withdrawn without any authorization of the court. (1977, c. 870, s. 1.)

Editor's Note. — Article 7A of Chapter 54, referred to in this section, was repealed by Session Laws 1981, c. 282, s. 1. For present provisions as to savings and loan associations, see Chapter 54B.

§ 28A-8-2. Provisions of bond.

A bond given pursuant to this Article shall be:

(1) Payable to the State to the use of all persons interested in the estate; and

(2) Conditioned that the personal representative giving the bond shall faithfully execute the trust reposed in him and obey all lawful orders of the clerk of superior court or other court touching the administration of the estate committed to him; and

(3) In an amount not less than:

  a. One and one-fourth times the value of all personal property of the decedent when the bond is secured by a suretyship bond executed by a corporate surety company authorized by the Commissioner of Insurance to do business in this State, provided that the clerk of superior court, when the value of the personal property to be administered by the personal representative exceeds one hundred thousand dollars ($100,000), may accept bond in an amount equal to the value of the personal property plus ten percent (10%) thereof; or

  b. Double the value of all personal property of the decedent when the bond is secured by one of the methods provided in subdivision (4)b, (4)c or (4)d; such value of said personal property to be ascertained by the clerk of superior court by examination, on oath, of the applicant or of some other person determined by the clerk to be qualified to testify as to its value; and

(4) Secured by one or more of the following:

  a. Suretyship bond executed, at the expense of the estate, by a corporate surety company authorized by the Commissioner of Insurance to do business in this State;

  b. Suretyship bond executed and justified upon oath before the clerk of superior court by two or more sufficient personal sureties each of whom shall reside in and own real estate in North Carolina and shall have assets with an aggregate value above encumbrances of not less than the amount of the penalty of the required bond;

  c. A first mortgage or first deed of trust in form approved by the administrative officer of the courts on real estate located in North Carolina:

    1. Executed by the owner, and conditioned on the performance of the obligations of the bond, and

    2. Containing a power of sale which, in the case of a mortgage, is exercisable by the clerk of superior court upon a breach of any condition thereof, or, in the case of a deed of trust, is exercisable by the trustee after notice by the clerk of superior court that a breach of condition has occurred.

  The clerk of superior court shall not accept such mortgage or deed of trust until it shall have been properly registered in the county or counties in which the real estate is located, and the clerk of superior court is satisfied that the real estate subject to the mortgage or deed of trust is worth the amount to be secured thereby, and that the mortgage or deed of trust is a first charge on said real estate. No such mortgage or deed of trust shall be cancelled or surrendered until the approval of the final account, unless substitution is permitted as provided in G.S. 28A-8-3(d).

d. A deposit by the owner with the clerk of superior court of negotiable securities, of a kind permitted by law to be proper investments for fiduciaries exercising due care, having a fair market value determined by the clerk to be equal to the amount of the penalty of the bond. Such securities shall be properly endorsed, delivered to the clerk of superior court, and accompanied by a security agreement containing a power of sale authorizing the clerk of superior court to sell them in the event the person to whom letters are being issued commits a breach of any duty imposed upon him by law in respect of his office. Such securities shall not be surrendered by the clerk of superior court to the owner until the approval of the final account, unless substitution is permitted as provided in G.S. 28A-8-3(d). For the purposes of determining the value of the assets of the personal sureties in subdivision (4)b, or the value of the real estate in subdivision (4)c, or the value of the negotiable securities in subdivision (4)d, the clerk of superior court may require a certificate of the value of such property by one or more persons not interested in the estate determined by the clerk to be qualified to certify such value. (C.C.P., s. 468; 1870-1, c. 93; Code, s. 1388; Rev., s. 319; C.S., s. 33; 1935, c. 386; 1949, c. 971; 1967, c. 41, s. 1; 1973, c. 1329, s. 3.)

Cross References. — As to mortgage in lieu of bond required to be given, see G.S. 58-74-1. As to deposit of cash or securities in lieu of bond, see G.S. 58-75-1. As to when evidence as to default of principal is admissible against sureties in actions on bonds of personal representatives, see G.S. 58-76-25.

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

When Bond Not Essential. — The execution of a bond, though incidental, is not an essential condition of an order admitting the plaintiff to prosecute an action as administrator. Hughes v. Hodges, 94 N.C. 56 (1886).

Bond Not Essential to Appointment Itself. — Giving of the bond is not essential to the efficiency of the act of appointment itself. Howerton v. Sexton, 104 N.C. 75, 10 S.E. 148 (1889). See Hoskins v. Miller, 13 N.C. 360 (1830); Spencer v. Cahoon, 15 N.C. 225 (1833); Spencer v. Cahoon, 18 N.C. 27 (1834); Garrison v. Cox, 95 N.C. 353 (1886).

The giving of the bond is not an essential of the act of appointment itself. In re Estate of Pitchi, 231 N.C. 485, 57 S.E.2d 649 (1950).

Failure to give a bond or the giving of an insufficient bond is only an irregularity, in no way affecting the validity of the appointment. The irregularity makes the letters of administration voidable only — a condition which may be cured by full compliance with the statute since the letters once issued are not subject to collateral attack. In re Estate of Pitchi, 231 N.C. 485, 57 S.E.2d 649 (1950).

Irregularity Cured by Giving Proper Bond. — Where, upon service of order to show cause why letters of administration should not be revoked for failure of the administrator to give bond, the administrator files bond with sufficient surety which is approved by the clerk, the irregularity is cured and the denial of the motion to vacate the letters of administration is not error. In re Estate of Pitchi, 231 N.C. 485, 57 S.E.2d 649 (1950).

Effect of Failure to Give Proper Bond. — The mere fact that the bond of the representative is not justified before or approved by the clerk does not render the appointment void, or necessarily voidable. The provisions of this section requiring bond are directory and not essential to the appointment. The only effect of noncompliance with these requirements is that the representative may be made to give the proper bond required. Garrison v. Cox, 95 N.C. 353 (1886).

Failure of Foreign Executor to Give Bond. — When a foreign executor was regularly appointed and qualified his failure to give the bond specified by this section is only an irregularity and cannot be collaterally attacked. Batchelor v. Overton, 158 N.C. 395, 74 S.E. 20 (1912).

Amount of Bond. — The framers of this section must have contemplated that the amount of bond should depend upon the application and examination of the principal named in it, unless the clerk preferred to examine another person. Upon the examination the clerk may value the property at a higher figure than he has previously valued it. Williams v. Neville, 108 N.C. 559, 13 S.E. 240 (1891).

Money Received Covered by Bond. — Money applied for by an administrator, and paid to him as such, is received under color of his office and is covered by his bond. Lafferty v. Young, 125 N.C. 296, 34 S.E. 444 (1899).

Good faith and the exercise of ordinary care and reasonable diligence are all that is required of executors and administrators, and covered by their bond. Moore v. Eure, 101 N.C. 11, 7 S.E. 471 (1888); Smith v. Patton, 131 N.C. 396, 42 S.E. 849 (1902).

Failure to account for and to pay an amount due by the administrator to the estate is a breach of the statutory bond. State ex rel. Dunn v. Dunn, 206 N.C. 373, 173 S.E. 900 (1934).

Action May Be Brought on Bond After Death or Removal of Administrator. — Where an administrator, who has not fully administered the estate of his intestate has died or has been removed from his office, an action may be maintained against his personal representative or against him, as the case may be, and the surety on his bond, to recover the amount due by him to the estate of his intestate, by one who has been duly appointed and has duly qualified as administrator d.b.n. of his intestate. Tulburt v. Hollar, 102 N.C. 406, 9 S.E. 430 (1889).

OPINIONS OF ATTORNEY GENERAL

Husband and Wife Constitute One Surety. — See opinion of Attorney General to Honorable Robert G. Jarrett, 42 N.C.A.G. 259 (1973), rendered under former Chapter 28.

§ 28A-8-3. Modification of bond requirements.

(a) Increase of Bond or Security in Case of Inadequacy or Insufficiency. — The clerk of superior court may, on his own motion or upon verified application of any person interested in the estate, require the personal representative to give a new bond or to furnish additional security if he finds that the bond filed pursuant to this Article, or its security, is insufficient, inadequate in amount, or that any of the individual sureties has become or is about to become a nonresident or, in the case of a corporate surety, has withdrawn or is about to withdraw from doing business in this State. Before ordering the personal representative to give a new bond or furnish additional security, the clerk of superior court shall issue a citation requiring the personal representative, within 10 days after service thereof, to show cause why such action should not be taken. If the clerk of superior court finds that the bond filed or its security is insufficient or inadequate, he shall make an order requiring the personal representative to give a new bond or to furnish additional security within a reasonable time to be fixed in the order.

(b) Increase of Bond upon Sale of Real Estate. — When a personal representative makes application for an order to sell real estate, the provisions of G.S. 1-339.10 shall govern.

(c) Reduction of Bond. — On application of the personal representative the penalty of the bond may be reduced from time to time when the clerk of superior court finds that such reduction is clearly justified, but in no event shall the penalty of the bond be reduced below the amount required by G.S. 28A-8-2(3).

(d) Substitution of Security. — When a bond is secured by a mortgage or deed of trust on real estate as provided in G.S. 28A-8-2(4)c or a deposit of negotiable securities as provided in G.S. 28A-8-2(4)d, the clerk of superior court may, on application of the personal representative, order that such real estate or negotiable securities, or a part thereof, be released upon the substitution therefor of other security in compliance with G.S. 28A-8-2(4)a, (4)c, or (4)d. Such substitution may be allowed in conjunction with any other modification of bond requirements permitted by this section. (1868-9, c. 113, s. 89; Code, s. 1518; Rev., s. 32; C.S., s. 43; 1973, c. 1329, s. 3.)

CASE NOTES

Mortgage Instead of Bond. — An administrator who is also the heir of the intestate cannot satisfy the requirement of an additional bond or security by mortgaging lands of his intestate, as such lands are already liable for the debts. In re Sellars, 118 N.C. 573, 24 S.E. 430 (1896), decided under prior law.

§ 28A-8-4. Failure to give additional bond; letters revoked.

If any personal representative fails to give an additional bond or new bond or to furnish additional security as ordered by the clerk of superior court pursuant to the provisions of this Article, within the time specified in any such order, the clerk of superior court shall proceed as provided in G.S. 28A-9-2. (1868-9, c. 113, s. 91; Code, s. 1520; Rev., s. 34; C.S., s. 44; 1973, c. 1329, s. 3.)

CASE NOTES

Clerk Has Jurisdiction. — The clerks of the superior courts have jurisdiction of proceedings for the removal of executors and administrators. Edwards v. Cobb, 95 N.C. 4 (1886), decided under prior law.

Notice to Show Cause Essential. — A judgment removing a public administrator for failure to renew his bond, without notice to show cause, is not only irregular but void. Trotter v. Mitchell, 115 N.C. 190, 20 S.E. 386 (1894), decided under prior law.

§ 28A-8-5. Rights of surety in danger of loss.

Any surety on the bond of a personal representative who is in danger of loss under his suretyship may file his petition on oath with the clerk of superior court setting forth the facts, and asking that such personal representative be removed from office, or that he be required to give security to indemnify the petitioner against apprehended loss, or that the petitioner be discharged as surety and be released from liability for any future breach of the bond. The clerk of superior court shall thereupon issue a citation to the personal representative, requiring him to answer the petition within 10 days after service thereof. If, upon the hearing, the clerk of superior court determines that the surety is entitled to relief, he may grant the same in such manner as to serve the best interest of the estate. In any event, however, the previous surety shall not be released from liability for any breach of duty by the personal representative occurring prior to the filing of bond with a new surety unless the new surety assumes liability for the earlier breaches. (1868-9, c. 113, s. 90; Code, s. 1519; Rev., s. 33; C.S., s. 41; 1973, c. 1329, s. 3.)

§ 28A-8-6. Action against obligors on bond of personal representative.

Any person injured by the breach of any bond given by a personal representative or collector may institute a civil action against one or more of the obligors of the bond and recover such damages as he may have sustained. Any successor personal representative, or any other personal representative of the same decedent, may institute such action on behalf of the persons interested in the estate. Any such action against one or more of the obligors of the bond shall be brought in the name of the State of North Carolina and shall be instituted in the county in which letters were issued to the personal representative or collector, and the clerk of superior court shall give notice of the institution of the action in such manner as he may determine to all other persons shown by his records to be interested in the estate. The bond of the personal representative is not void after the first or any subsequent recovery thereon until the entire penalty is recovered. If the plaintiff fails to prevail, costs may be taxed against the person or persons for whose benefit the action on a personal representative's bond is prosecuted. (1868-9, c. 113, ss. 87, 88; Code, ss. 1516, 1517; Rev., ss. 30, 31; C.S., ss. 40, 42; 1973, c. 1329, s. 3.)

CASE NOTES

Necessity for Administrator De Bonis Non to Sue. — The administrator de bonis non must first sue on the bond of a defaulting executor who preceded him, before he can obtain a license to sell the real estate for the payment of the debts. Carlton v. Byers, 70 N.C. 691 (1874), decided under prior law.

Where the preceding administrator is insolvent, his bond lost, and sureties unknown, the administrator de bonis non need not bring suit before he can obtain such license. Brittain v. Dickson, 104 N.C. 547, 10 S.E. 701 (1889), decided under prior law.

Cited in State ex rel. Pilard v. Berninger, 154 N.C. App. 45, 571 S.E.2d 836, 2002 N.C. App. LEXIS 1407 (2002), cert. denied, 356 N.C. 694, 579 S.E.2d 100 (2003).

ARTICLE 9.

Revocation of Letters.

§ 28A-9-1. Revocation after hearing.

(a) Grounds. — Letters testamentary, letters of administration, or letters of collection may be revoked after hearing on any of the following grounds:

(1) The person to whom they were issued was originally disqualified under the provisions of G.S. 28A-4-2 or has become disqualified since the issuance of letters.

(2) The issuance of letters was obtained by false representation or mistake.

(3) The person to whom they were issued has violated a fiduciary duty through default or misconduct in the execution of his office, other than acts specified in G.S. 28A-9-2.

(4) The person to whom they were issued has a private interest, whether direct or indirect, that might tend to hinder or be adverse to a fair and proper administration. The relationship upon which the appointment was predicated shall not, in and of itself, constitute such an interest.

(b) Procedure. — When it appears to the clerk of superior court, on his own motion or upon verified complaint made to him by any person interested in the estate, that any of the grounds set forth in subsection (a) may exist with regard to any personal representative or collector within his jurisdiction, he shall issue citation requiring such personal representative or collector, within 10 days after service thereof, to show cause why his letters should not be revoked. On the return of such citation duly executed, the clerk of superior court shall set the date for a hearing. Notice of the time and date of the hearing shall be given to such persons and in such manner as the clerk of superior court shall determine. If at the hearing the clerk of superior court finds any one of the grounds set forth in subsection (a) to exist, he shall revoke the letters issued to such personal representative or collector. (C.C.P., s. 470; Code, s. 2171; Rev., s. 38; C.S., s. 31; 1921, c. 98; 1953, c. 795; 1973, c. 1329, s. 3.)

Cross References. — As to appeal from an order of the clerk granting or denying revocation, see G.S. 28A-10-6.

CASE NOTES

I. General Consideration.
II. Disqualification.
III. Default or Misconduct.
IV. Private Interest.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

This section prescribes procedure for the removal of a particular person as administrator for causes specified therein; and, upon removal of such person, the clerk must immediately appoint some other person to succeed in the administration of the estate. In re Bane, 247 N.C. 562, 101 S.E.2d 369 (1958).

Section 1A-1, Rule 58 Inapplicable to Denial of Motion to Revoke. — Section 1A-1, Rule 58 has no application in case involving the denial of a motion made before the clerk of superior court pursuant to this section to revoke the letters testamentary of executor. In re Estate of Trull, 86 N.C. App. 361, 357 S.E.2d 437 (1987).

Purpose of Proceeding to Remove Executor or Administrator. — See In re Battle's Estate, 158 N.C. 388, 74 S.E. 23 (1912).

Power to Revoke Imports Power to Refuse. — The power vested in the clerk under this section to revoke letters for good cause carries with it the power to refuse to grant letters for cause for which a revocation would be justified. In re Will of Gulley, 186 N.C. 78, 118 S.E. 839 (1923).

Jurisdiction of Clerk. — The clerk has original and primary jurisdiction of a probate judge to revoke letters, subject to review upon appeal by either party. Murrill v. Sandlin, 86 N.C. 54 (1882); McMichael v. Proctor, 243 N.C. 479, 91 S.E.2d 231 (1956).

The clerk of superior court, as probate judge, has exclusive original jurisdiction to hear and decide a motion to remove an administrator for cause. Porth v. Porth, 3 N.C. App. 485, 165 S.E.2d 508 (1969).

The clerk of the superior court has jurisdiction to entertain verified petition for the removal of an administrator. In re Estate of Johnson, 232 N.C. 59, 59 S.E.2d 223 (1950).

Jurisdiction of Clerk over Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against her based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Exercise of Discretion. — The exigencies of administration require the exercise of sound judgment, and this necessarily implies discretion in its supervision. Hence, the removal of administrators calls for the exercise of discretion by the clerk. Jones v. Palmer, 215 N.C. 696, 2 S.E.2d 850 (1939).

Discretion Reviewable on Appeal. — In revoking letters of administration under this section the clerk exercises a legal discretion which is reviewable on appeal. In re Galloway's Estate, 229 N.C. 547, 50 S.E.2d 563 (1948); In re Will of Taylor, 293 N.C. 511, 238 S.E.2d 774 (1977).

Revocation of Prior Appointment and Appointment of Widow's Nominee. — The appointment of one as administrator of an estate should be revoked upon renunciation of the widow, who has a prior right to administer the estate, and her nomination of another in her stead, and the clerk of the court has jurisdiction and should appoint on her request a fit and competent person nominated by her. In re Estate of Loflin, 224 N.C. 230, 29 S.E.2d 692 (1944).

Filling Vacancy Caused by Resignation. — Where, in proceedings for removal of an administrator, the administrator resigns, a vacancy occurs and the clerk has authority to appoint a successor. In re Estate of Johnson, 232 N.C. 59, 59 S.E.2d 223 (1950).

Filing of "Final Report" Does Not Create Vacancy. — The filing of a "final report" by an executor does not have the effect of removing him from office if in fact the estate has not been fully settled, and therefore the filing of the report does not create a vacancy and does not give the clerk authority to appoint an administrator c.t.a., d.b.n. Edwards v. McLawhorn, 218 N.C. 543, 11 S.E.2d 562 (1940).

Pleading and Procedure. — The application to remove an executor may be made by any person rightfully interested, by petition or motion in writing, or formal complaint, setting forth the grounds of application supported by affidavit. The allegations thus made may be met by a demurrer in a proper case, or by answer. Edwards v. Cobb, 95 N.C. 4 (1886).

Because hearings both to compel accountings and remove personal representative are instituted by notice rather than a formal civil complaint and summons, they are "special proceedings," for which beneficiaries are not required to commence a civil action. In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Necessity for Order to Show Cause. — The clerk cannot appoint a collector, when the will has been probated and executor qualified, and remove the executor, without a hearing based on notice to show cause why the executor should not be removed. In re Palmer's Will, 117 N.C. 133, 23 S.E. 104 (1895).

Clerk cannot remove a public administrator without notice to show cause why he should not be removed. Trotter v. Mitchell, 115 N.C. 190, 20 S.E. 386 (1894).

Finding Sufficient to Support Revocation. — Findings that an administrator had moved from the jurisdiction of this State and had interests antagonistic to the estate was sufficient to support the clerk's order revoking letters of administration. In re Sams' Estate, 236 N.C. 228, 72 S.E.2d 421 (1952).

Order of revocation of letters testamentary was justified where the clerk made a finding that executor had refused to pay widow her share from the sale of personal property, and that he had arbitrarily mixed and commingled funds of the estate with funds of the widow. In re Boyles' Estate, 243 N.C. 279, 90 S.E.2d 399 (1955).

Proceeding to remove an executor and a civil suit for damages are not the same cause of action. The proceeding to remove an executor is purely statutory, with probate jurisdiction vested in the clerk of superior court, and reviewable by a superior court judge on appeal. A civil suit for damages involves a full trial with the right to have factual issues resolved by a jury. Shelton v. Fairley, 72 N.C. App. 1, 323 S.E.2d 410 (1984), cert. denied, 313 N.C. 509, 329 S.E.2d 394 (1985).

Statutory action to remove administrators or executors is not res judicata in any other proceeding which the parties are entitled to pursue. Shelton v. Fairley, 72 N.C. App. 1, 323 S.E.2d 410 (1984), cert. denied, 313 N.C. 509, 329 S.E.2d 394 (1985).

A proceeding under this section is not res judicata in a civil action for damages. Shelton v. Fairley, 72 N.C. App. 1, 323 S.E.2d 410 (1984), cert. denied, 313 N.C. 509, 329 S.E.2d 394 (1985).

Orders entered in a proceeding under this section, in which an executor must show cause why he should not be removed, do not constitute res judicata as to a later civil action for damages between the parties or collaterally estop the bringing of such an action. Shelton v. Fairley, 72 N.C. App. 1, 323 S.E.2d 410 (1984), cert. denied, 313 N.C. 509, 329 S.E.2d 394 (1985).

An adjudication by the clerk that the administratrix theretofore appointed by him was not the widow of decedent is not res judicata in any other proceeding between the parties which respondent may be entitled to pursue. In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Beneficiaries Seeking Removal Not Held to Election of Remedies. — Prejudice would result if, when beneficiaries sought to remove an executor, they were held to an election of remedies and could not later bring a civil action for damages. Such a policy would either chill exercise of the right to seek statutory removal of an executor or force beneficiaries prematurely to bring civil actions for damages. Shelton v. Fairley, 72 N.C. App. 1, 323 S.E.2d 410 (1984), cert. denied, 313 N.C. 509, 329 S.E.2d 394 (1985).

Denial of Motion to Revoke "Entered" When Clerk Announced After Hearing He Would Deny It. — Clerk's order denying motion to revoke letters testamentary was "entered" when the clerk announced after hearing that he would deny the petition. The party aggrieved by the ruling, the petitioner, was present and even excepted to the order, had ten days thereafter to give notice of appeal pursuant to G.S. 1-272 [see now G.S. 1-301.1 et seq.]. In re Estate of Trull, 86 N.C. App. 361, 357 S.E.2d 437 (1987).

Verification Sufficient. — Signing of petition for revocation before a notary public under oath, petitioner having sworn that the matters stated in the petition upon her information and belief were true, constituted sufficient verification required by this section. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

"Special Proceeding." — The procedure for the revocation of the letters testamentary of an administratrix as set forth in this section is a "special proceeding," and the clerk had statutory authority to appoint the guardian ad litem. In re Estate of Sturman, 93 N.C. App. 473, 378 S.E.2d 204 (1989).

The minor heirs had a vested interest in who administered the estate of their deceased father and were entitled under this section to appeal the decision of the clerk on the revocation issue. This was sufficient to bring the matter within the purview of Rule 17 providing it was an "action or special proceeding." In re Estate of Sturman, 93 N.C. App. 473, 378 S.E.2d 204 (1989).

Applied in In re Estate of Montgomery, 137

N.C. App. 564, 528 S.E.2d 618, 2000 N.C. App. LEXIS 422 (2000); In re Estate of Monk, 146 N.C. App. 695, 554 S.E.2d 370, 2001 N.C. App. LEXIS 1078 (2001), cert. denied, 355 N.C. 212, 559 S.E.2d 805 (2002) .

Cited in In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977); Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981); In re Estate of Armfield, 113 N.C. App. 467, 439 S.E.2d 216 (1994).

II. DISQUALIFICATION.

"Legally Competent." — As to definition of term "legally competent" under former statute, see In re Will of Covington, 252 N.C. 551, 114 S.E.2d 261 (1960).

III. DEFAULT OR MISCONDUCT.

Procedure to remove an executor or administrator for default or misconduct is by order issued by the clerk to the executor or administrator to show cause, and in such proceeding the respondent must be given notice and an opportunity to be heard, with right of appeal. Edwards v. McLawhorn, 218 N.C. 543, 11 S.E.2d 562 (1940).

Question Determinable by Clerk. — In a proceeding under this section for revocation of letters of administration, the question determinable by the clerk was solely whether the administrators have been guilty of default or misconduct in the due execution of their office, and the rights and liabilities of adverse parties in the estate could not be litigated in such proceeding. In re Galloway's Estate, 229 N.C. 547, 50 S.E.2d 563 (1948).

Failure to Discharge Duties as Ground of Removal. — Where the executor becomes bankrupt and is the owner of no property, and has neglected for six years to file an inventory or return of any sort, and has failed to convert the personal property into money, upon application of creditors he may be required to give bond or, in default, be removed. Barnes v. Brown, 79 N.C. 401 (1878).

As to removal for failure to make statement of account, see Armstrong v. Stowe, 77 N.C. 360 (1877).

Refusal to Disclose Information. — Refusal on the part of the executor named in the will to disclose information as to the amount and nature of personalty coming into his possession, and as to other matters relative to his fitness, is a ground for withholding or revoking letters testamentary and granting them to some other person. In re Will of Gulley, 186 N.C. 78, 118 S.E. 839 (1923).

Poverty of an executor is not of itself a reason for restraining him from administering the estate. There must be some maladministration or some danger of loss from his misconduct or negligence for which he will not be able to answer by reason of his insolvency. Wilkins v. Harris, 60 N.C. 592 (1864).

Poverty is not a ground to require the representative to give bond as an alternative of giving up his office. Fairbairn v. Fisher, 57 N.C. 390 (1859).

Insolvency in Lifetime of Testator. — An executor will not be removed for insolvency, if such was his condition in the lifetime of his testator and to the knowledge of the testator, when there is no evidence of waste or misapplication of funds. In re Knowles' Estate, 148 N.C. 461, 62 S.E. 549 (1908).

Where heirs at law of an estate were appointed administrators, an order of the clerk revoking the letters of administration upon consideration of evidence of their failure to account for rents and profits from the realty is based upon a confusion of their duties, obligations and liabilities as administrators and their rights and liabilities as heirs at law, and the cause will be remanded in order that the evidence may be considered in its true legal light. In re Galloway's Estate, 229 N.C. 547, 50 S.E.2d 563 (1948).

Failure of Nonresident Executrix to Appoint Process Agent. — The failure and refusal by a nonresident executrix to appoint a process agent was sufficient ground under this section for her removal. In re Brauff's Will, 247 N.C. 92, 100 S.E.2d 254 (1957).

Where decedent's daughter repeatedly requested that wrongful death action be brought, and offered to pay all expenses for it, but was confronted with alleged collusion and willful obstruction on the part of administratrix and attorney, and within the two-year statute of limitations period, filed action against administratrix, attorney and insurer alleging breach of fiduciary duties and collusion, her contributory negligence, if any, in failing to seek removal of administratrix, was not such as to warrant dismissal under G.S. 1A-1, Rule 12(b)(6). Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984).

Executor's acceptance of commissions based on an erroneous interpretation of a statute would not be misconduct requiring revocation of letters testamentary. Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988), aff'd, 324 N.C. 541, 379 S.E.2d 857 (1989).

Statement of Belief in Affidavit Is Insufficient. — A statement in an affidavit for the removal of executor of a mere belief that he will misapply the funds is not sufficient for removal. The affidavit should state the facts or reasons upon which such belief is based. Neighbors v. Hamlin, 78 N.C. 42 (1878).

Allegations of Misconduct Held Sufficient. — Allegations that coexecutor failed to timely file estate accountings with the clerk's office, disregarding notices issued by the clerk that such accountings were due, that he paid himself approximately $32,900 from the estate for his commission and attorneys' fees without approval of the clerk and that this amount was in excess of any amount which he could legally be allowed for commissions and legal fees, and that through his default and misconduct he had violated his fiduciary duty as a coexecutor of the estate constituted sufficient grounds upon which executrix could petition for the revocation of coexecutor's letters under subdivision (a)(3) of this section. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied, 314 N.C. 330, 333 S.E.2d 488 (1985).

IV. PRIVATE INTEREST.

Interest in Property Which Is Liable for Estate Debt. — The finding that respondent-administrator c.t.a. and petitioner are tenants in common of certain real property of the estate which is liable for debts of the estate to the extent that the personal property is insufficient to pay such debts does not support the conclusion that respondent had a private interest that might tend to hinder or be adverse to a fair and proper administration of the estate. In re Will of Taylor, 32 N.C. App. 742, 234 S.E.2d 11, aff'd, 293 N.C. 511, 238 S.E.2d 774 (1977).

Joint Ownership with Decedent. — Where there is no evidence of bad faith or fraudulent concealment, a claim by the administrator that he owned jointly with the decedent a part of the personal estate of the latter is not such an adverse interest as to disqualify him in his office. Morgan v. Morgan, 156 N.C. 169, 72 S.E. 206 (1911).

§ 28A-9-2. Summary revocation.

(a) Grounds. — Letters testamentary, letters of administration, or letters of collection, shall be revoked by the clerk of superior court without hearing when:

(1) After letters of administration or collection have been issued, a will is subsequently admitted to probate.

(2) After letters testamentary have been issued:

a. The will is set aside, or

b. A subsequent testamentary paper revoking the appointment of the executor is admitted to probate.

(3) Any personal representative or collector required to give a new bond or furnish additional security pursuant to G.S. 28A-8-3 fails to do so within the time ordered.

(4) A nonresident personal representative refuses or fails to obey any citation, notice, or process served on him or his process agent.

(5) A trustee in bankruptcy, liquidating agent, or receiver has been appointed for any personal representative or collector, or any personal representative or collector has executed an assignment for the benefit of creditors.

(6) A personal representative has failed to file an inventory or an annual account with the clerk of superior court, as required by Article 20 and Article 21 of this Chapter, and proceedings to compel such filing pursuant to G.S. 28A-20-2 or 28A-21-4 cannot be had because service cannot be completed because the personal representative cannot be found.

(b) Procedure. — Upon the occurrence of any of the acts set forth in subsection (a), the clerk of superior court shall enter an order revoking the letters issued to such personal representative or collector and shall cause a copy of the order to be served on him or his process agent. (C.C.P., s. 469; Code, s. 2170; Rev., s. 37; C.S., s. 30; 1973, c. 1329, s. 3; 1975, c. 19, s. 8.)

Cross References. — As to resignation of trustee or other fiduciary, see G.S. 36A-22 et seq.

CASE NOTES

This section does not empower the clerk to set aside probate in common form upon proffer of proof of a later will. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948), decided under prior law.

Cited in In re Will of Taylor, 293 N.C. 511, 238 S.E.2d 774 (1977); In re Will of Taylor, 32 N.C. App. 742, 234 S.E.2d 11 (1977); In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-9-3. Effect of revocation.

Upon entry of the order revoking his letters, the authority of the personal representative or collector shall cease. He shall surrender all assets of the estate under his control to his successor, or the remaining personal representative or collector or to the clerk of superior court; and shall file an accounting in the form prescribed by Article 21 of this Chapter. A personal representative or collector whose letters are revoked pursuant to G.S. 28A-9-2(a)(1) or 28A-9-2(a)(2) shall not thereby incur personal liability for administrative acts performed prior to revocation except as provided in G.S. 28A-13-10. (1973, c. 1329, s. 3.)

§ 28A-9-4. Appeal; stay effected.

Any interested person may appeal from the order of the clerk of superior court granting or denying revocation. The procedure shall be the same as in a special proceeding. If the clerk of superior court has revoked the letters, such appeal shall stay the judgment and order of the clerk until the cause is heard and determined upon appeal. (1973, c. 1329, s. 3.)

Cross References. — As to revocation of letters testamentary, letters of administration, or letters of collection after hearing, see G.S. 28A-9-1.

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Power of Clerk to Remove Executors, etc., Is Reviewable. — The powers of the clerk to remove executors and administrators, conferred by this section, are reviewable on appeal to the judge of the superior court of the county. Wright v. Ball, 200 N.C. 620, 158 S.E. 192 (1931).

It is in the province of the clerk to pass upon the matter of qualification of an executor, subject to the right of review by the superior court judge, and as to matters of law by the Supreme Court on appeal. In re Will of Gulley, 186 N.C. 78, 118 S.E. 839 (1923). See Tulburt v. Hollar, 102 N.C. 406, 9 S.E. 430 (1889).

Superior Court May Review Findings of Fact Challenged by Specific Exceptions. — To say that the superior court has jurisdiction to hear a probate matter only upon an appeal from a final judgment entered below does not mean that the judge can review the record only to ascertain whether there have been errors of law. He also reviews any findings of fact which the appellant has properly challenged by specific exceptions. In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Jurisdiction of Superior Court is Derivative. — It is sometimes said that, upon an appeal from an order of the clerk made in the performance of his duties as judge of probate, the jurisdiction of the judge of the superior court is derivative. Such derivative jurisdiction is construed to mean, inter alia (1) that the clerk of the superior court has the sole power in the first instance to determine whether a decedent died testate or intestate, and, if he died testate, whether the paper-writing offered for probate is his will; (2) that proceedings to repeal letters of administration must be commenced before the clerk who issued them in the first instance; and (3) that the judge of the superior court has no jurisdiction to appoint or remove an administrator or a guardian. In other words, jurisdiction in probate matters cannot be exercised by the judge of the superior court except upon appeal. In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Hearing De Novo. — Where the clerk removes an administratrix upon his finding that she was not the widow of the deceased and therefore was not entitled to appointment as a matter of right, and an appeal is taken to the superior court from such order, the superior court, even though its jurisdiction is derivative, hears the matter de novo, and may review the finding of the clerk provided the appellant has properly challenged the finding by specific exception, and may hear evidence and even submit the controverted fact to the jury; but where there is no exception to the finding, the superior court may determine only whether the finding is supported by competent evidence, and if the order is so supported the superior court is without authority to vacate the clerk's judgment and order a jury trial upon the issue. In re Estate of Lowther, 271 N.C. 345, 156 S.E.2d 693 (1967).

Superior Court May Retain Cause. — Where the superior court judge, upon appeal from the order of the clerk of the court removing executors or administrators of an estate, has exercised his discretion in retaining the cause in the superior court instead or remanding it to the clerk, the exercise of this discretion is not reviewable on appeal to the Supreme Court. Wright v. Ball, 200 N.C. 620, 158 S.E. 192 (1931).

Cited in Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

§ 28A-9-5. Interlocutory orders.

Pending any proceeding or appeal with respect to revocation of letters, the clerk of superior court may enter such interlocutory orders as are necessary to preserve the assets of the estate. (1868-9, c. 113, s. 92; Code, s. 1521; Rev., s. 35; C.S., s. 32; 1973, c. 1329, s. 3.)

CASE NOTES

Order to Make Return and Settlement. — The removed administrator may be ordered to make immediate return and settlement of the estate in his hands. Until that is done he is within the jurisdiction of the court. In re Brinson, 73 N.C. 278 (1875), decided under prior law. See also, Taylor v. Biddle, 71 N.C. 1 (1874), where an administrator was removed and an administrator de bonis nom appointed, decided under prior law.

Order to Surrender Funds. — It is proper for the clerk to order the displaced representative to surrender the funds in his possession belonging to the estate. Battle v. Duncan, 90 N.C. 546 (1884), decided under prior law.

Cited in In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-9-6. Appointment of successor to personal representative or collector whose letters have been revoked; when not required.

Upon the revocation of letters issued to a sole or last surviving personal representative or collector, the clerk of superior court shall appoint another personal representative or collector as provided by G.S. 28A-4-1 to act as his successor. When two or more personal representatives or collectors have qualified, and the letters of one or more personal representatives or collectors are revoked, leaving in office one or more personal representatives or collectors, the appointment of successors shall not be required unless:

(1) The clerk of superior court determines, in his discretion, that it is in the best interest of the estate to appoint a successor or successors to the personal representatives or collectors whose letters have been revoked, or

(2) In the case of executors, the will so provides. (1868-9, c. 113, s. 92; Code, s. 1521; Rev., s. 35; C.S. 32; 1973, c. 1329, s. 3.)

CASE NOTES

Clerk is required to immediately appoint some person to succeed in the administration of the estate, and it is immaterial so far as continuity of the succession is concerned whether the successor be administrator d.b.n., executor, administrator c.t.a., administrator c.t.a., d.b.n., or collector, Harrison v. Carter, 226 N.C. 36, 36 S.E.2d 700, 164 A.L.R. 697 (1946), decided under prior law.

Successor Cannot Be Appointed until Vacancy Exists. — Since a person to whom letters testamentary have been issued has authority to represent the estate until his death, resignation or until he has been removed or the letters testamentary have been revoked in accordance with statutory procedure, the appointment by the clerk of an administrator c.t.a., d.b.n., upon petition of the residuary legatee alleging failure of the executor to account to the estate for rents and profits, is void, the clerk being without jurisdiction to make the appointment. Edwards v. McLawhorn, 218 N.C. 543, 11 S.E.2d 562 (1940), decided under prior law.

§ 28A-9-7. Rights and duties devolve on successor.

After the revocation of letters pursuant to this Article and upon the qualification and appointment of a successor, the substituted personal representative or collector shall succeed to all the powers stated in G.S. 28A-13-7. He shall be subject to all the duties, responsibilities and liabilities of the original personal representative or collector, other than liabilities arising out of the grounds for revocation. (1973, c. 1329, s. 3.)

ARTICLE 10.

Resignation.

§ 28A-10-1. Clerk's power to accept resignation.

The clerk of superior court in the county where a person has been appointed personal representative shall have the power to accept his resignation. (1973, c. 1329, s. 3.)

§ 28A-10-2. Contents of petition; notice.

(a) When a personal representative desires to resign his office, he shall file a verified petition in the office of the clerk of the superior court, setting forth:

(1) The facts relating to his appointment and qualifications;
(2) The names and residences of all interested persons known to him;
(3) A full statement of the reasons why the petitioner should be permitted to resign his office; and
(4) A statement that he has filed with the clerk of superior court his accounts and a record of his conduct of the office.

(b) Notice of the petition for resignation, together with the date and time of the hearing thereon, shall be served upon all interested persons named in the petition in such manner as the clerk of superior court shall determine. (1973, c. 1329, s. 3.)

§ 28A-10-3. Statement of account; record of conduct.

When the personal representative files his petition requesting permission to resign his office, he shall also file a verified statement of:

(1) His accounts since his qualification, or if he has previously filed an account, a statement of his accounts since the date thereof;
(2) The assets of the estate and their location;
(3) The debts and liabilities of the estate;

(4) All facts and circumstances known to him the disclosure of which is necessary for a full and fair assessment of his conduct of the office; and
(5) All additional facts and circumstances known to him the disclosure of which is necessary for a full and fair understanding of all matters concerning the estate. (1973, c. 1329, s. 3.)

§ 28A-10-4. Hearing; order.

The clerk of superior court shall conduct a hearing on the petition not sooner than 10 days nor later than 20 days after notice to interested persons pursuant to G.S. 28A-10-2(b). If the clerk of superior court finds all the accounts proper, including accounts subsequent to the filing of the petition, and determines that the resignation of the personal representative is in the best interest of the estate and can be allowed, the resignation may be approved subject to the provisions of G.S. 28A-10-5. Except in cases governed by G.S. 28A-10-8, he shall appoint a successor pursuant to G.S. 28A-4-1. (1973, c. 1329, s. 3.)

§ 28A-10-5. When resignation becomes effective.

The resignation shall not become effective until:
(1) A successor has been duly qualified, unless G.S. 28A-10-8 is applicable; and
(2) The clerk of superior court is satisfied that the accounts of the personal representative are true and correct; and
(3) The personal representative has accounted to his successor in full for all assets of the estate, or if pursuant to G.S. 28A-10-8 no successor is appointed, to the remaining personal representative or representatives, and his final account has been filed with and approved by the clerk of superior court. (1973, c. 1329, s. 3.)

CASE NOTES

Cited in Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754 (1983).

§ 28A-10-6. Appeal; stay effected.

Any interested person who has appeared at the hearing and objected to the order of the clerk of superior court granting or denying resignation may appeal therefrom. The procedure shall be the same as in a special proceeding. If the clerk of superior court has allowed the resignation, such appeal shall stay the order of the clerk until the cause is heard and determined upon appeal. (1973, c. 1329, s. 3.)

§ 28A-10-7. Rights and duties devolve on successor.

Upon the qualification and appointment of a successor to a personal representative whose resignation has been allowed as provided in G.S. 28A-10-4, the substituted personal representative shall succeed to all the powers stated in G.S. 28A-13-7 and shall also be subject to all the duties, responsibilities, and liabilities stated in Article 13. (1973, c. 1329, s. 3.)

§ 28A-10-8. When appointment of successor to personal representative who has resigned is not required.

When two or more personal representatives have qualified, and one or more personal representatives resign pursuant to this Article, leaving in office one or more personal representatives, the appointment of successors shall not be required unless:

(1) The clerk of superior court determines, in his discretion, that it is in the best interest of the estate to appoint a successor or successors to the personal representative or representatives who have resigned, or

(2) In the case of executors, the will so provides. (1973, c. 1329, s. 3.)

ARTICLE 11.

Collectors.

§ 28A-11-1. Appointment and qualifications of collectors.

When for any reason other than a situation provided for in Chapter 28B or Chapter 28C entitled "Estates of Absentees in Military Service" and "Estates of Missing Persons" a delay is encountered in the issuance of letters to a personal representative or when, in any case, the clerk of superior court finds that the best interest of the estate would be served by the appointment of a collector, he may issue letters of collection to any person or persons not disqualified to act as a personal representative under G.S. 28A-4-2. (R.C., c. 46, s. 9; C.C.P., s. 463; 1868-9, c. 113, s. 115; Code, s. 1383; Rev., s. 22; C.S., s. 24; 1924, c. 43; 1965, c. 815, s. 2; 1967, c. 24, s. 14; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

When Appointment Proper. — A collector is appointed only when there is no one in rightful charge of the estate, and this section is applicable only to cases where there are difficulties in limine disconnected with controversy or contest over the will, preventing the admission of the will to probate or the issuing of letters testamentary, e.g., protracted absence of witnesses, illness of the executor, etc., also where a caveat is entered at the time the will is offered to probate. In re Palmer's Will, 117 N.C. 133, 23 S.E. 104 (1895).

Appointee in Discretion of Clerk. — It is discretionary with the clerk to appoint as collector either the person named as executor in the writing purporting to be the will, or some other person. In re Little's Will, 187 N.C. 177, 121 S.E. 453 (1924).

Appointment for Purpose of Wrongful Death Action. — Pending the appointment and qualification of an administrator, or probate and filing of a will, a collector may be appointed in order that action for wrongful death may be instituted within the statutory time. Harrison v. Carter, 226 N.C. 36, 36 S.E.2d 700, 164 A.L.R. 697 (1946), citing In re Palmer's Will, 117 N.C. 133, 23 S.E. 104 (1895).

After Will Admitted to Probate. — After a will has been admitted to probate in common form and letters testamentary have been issued, the clerk cannot remove the executor and appoint a collector, without a hearing based on notice to show cause why the executor should not be removed. In re Palmer's Will, 117 N.C. 133, 23 S.E. 104 (1895).

§ 28A-11-2. Oath and bond.

Every collector shall take an oath as prescribed in G.S. 28A-7-1 and give bond as required in Article 8 of this Chapter for personal representatives. (C.C.P., s. 464; Code, s. 1384; Rev., s. 23; C.S., s. 25; 1973, c. 1329, s. 3.)

§ 28A-11-3. Duties and powers of collectors.

(a) Every collector shall:

(1) Take such possession, custody, or control of the personal property of the decedent as in the exercise of reasonable judgment he deems necessary to its preservation;

(2) Publish notices to creditors as provided by Article 14 of this Chapter;

(3) Collect claims payable to the estate;

(4) Maintain and defend actions in behalf of the estate;

(5) File inventories, accounts, and other reports in the same manner as is required of personal representatives;

(6) Renew obligations of the decedent in the same manner as the personal representative is allowed to do under the provisions of Article 13 of this Chapter; and

(7) Under the express direction and supervision of the clerk of superior court, possess, exercise and perform all other powers, duties and liabilities given to personal representatives by Article 13 of this Chapter. (R.C., c. 46, s. 6; C.C.P., s. 465; 1868-9, c. 113, s. 115; Code, s. 1385; Rev., s. 24; C.S., s. 26; 1973, c. 1329, s. 3.)

Editor's Note. — This section contains no subsection (b).

CASE NOTES

No Power to Lease Land Under Former Statute. — See Lee v. Lee, 74 N.C. 70 (1876), decided under prior law.

Cited in Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447 (1988).

§ 28A-11-4. When collectors' powers cease; settlement of accounts.

(a) When letters testamentary or letters of administration are issued, or when in any case the clerk of superior court terminates the appointment of the collector, the powers of the collector cease.

(b) Upon the termination of his appointment, the collector shall surrender to the personal representative or to the person otherwise entitled thereto or to the clerk all assets of the estate under this control and shall file with the clerk a verified statement of:

(1) His accounts since his qualification, or if he has previously filed an account, a statement of his accounts since the date thereof;

(2) The assets of the estate and their location;

(3) The debts and liabilities of the estate;

(4) All facts and circumstances known to him the disclosure of which is necessary for a full and fair assessment of his conduct of the office; and

(5) All additional facts and circumstances known to him the disclosure of which is necessary for a full and fair understanding of all matters concerning the estate.

(c) The clerk of superior court shall examine the account of the collector and if he finds all of the accounts proper, he shall by order approve the account. (R.C., c. 46, s. 7; C.C.P., s. 466; 1868-9, c. 113, s. 115; Code, s. 1386; Rev., s. 25; C.S., s. 27; 1973, c. 1329, s. 3.)

CASE NOTES

Allowance of Counsel Fee. — A collector who resists the claim of the executor is not entitled to an allowance for counsel fees paid by him in such litigation, where the executor prevails in the litigation. Johnson v. Marcom, 121 N.C. 83, 28 S.E. 58 (1897), decided under prior law.

§ 28A-11-5. Compensation.

A collector shall be compensated in accordance with Article 23 of this Chapter. (1977, c. 814, s. 4.)

Article 12.

Public Administrator.

§ 28A-12-1. Appointment and term.

There shall be a public administrator in every county, appointed by the clerk of superior court, with the written approval of the senior resident superior court judge of the district in which the appointment is made, for a term of four years. (1868-9, c. 113; Code, s. 1389; Rev., s. 18; C.S, s. 17; 1925, c. 253; 1973, c. 1329, s. 3.)

CASE NOTES

Property Right. — The public administrator's office is a property right which cannot be divested without due process of law. Trotter v. Mitchell, 115 N.C. 190, 20 S.E. 386 (1894), decided under prior law.

Not an Office Within Constitutional Prohibition Against Holding More Than One Office. — A public administrator is not a holder of a public office within the constitutional prohibition against holding more than one office, and hence a quo warranto proceeding will not lie against him simply because he is also holding the office of recorder. State v. Smith, 145 N.C. 476, 59 S.E. 649 (1907), decided under prior law.

Mistake of Clerk as to Term. — The appointment of a public administrator is for the time specified in the section, and is not affected by a mistake of the clerk in stating in the appointment that it was for the unexpired term of his predecessor, or fixing the term of the new appointee for less period. Boynton v. Heartt, 158 N.C. 488, 74 S.E. 470 (1912), decided under prior law.

§ 28A-12-2. Oath of office.

The public administrator shall take and subscribe an oath or affirmation in the form provided in G.S. 11-11 for administrators and in the manner provided in G.S. 28A-7-1; and the oath or affirmation so taken and subscribed shall be filed in the office of the clerk of superior court. (1868-9, c. 113, ss. 2, 5; Code, s. 1393; Rev., s. 19; C.S., s. 18; 1973, c. 1329, s. 3.)

Cross References. — As to form of oath, see G.S. 11-11.

§ 28A-12-3. Qualification and bond.

(a) The public administrator shall qualify and give bond with regard to each estate administered by him as provided in Article 8 of this Chapter, at the expense of such estate.

(b) As an alternative to and in lieu of the bonding requirement provided in subsection (a), the administrator may, in the discretion of the clerk of superior court, enter into a single permanent bond, secured by any of the methods provided in G.S. 28A-8-2(4), payable to the State of North Carolina, conditioned upon the faithful performance of the duties of his office and obedience to all lawful orders of the clerk of superior court or other court touching the administration of any estate committed to him. The amount of the permanent bond shall be determined by the clerk, based on the total value of all the estates administered by the public administrator, and may be increased or decreased from time to time as the clerk determines is necessary. The expense of the bond shall be borne by the estates administered by the administrator, as determined by the clerk. (1868-9, c. 113, ss. 2, 3, 4; Code, ss. 1390, 1391, 1392; Rev., s. 320; 1915, c. 216; C.S., s. 19; 1941, c. 243; 1973, c. 1329, s. 3; 1979, cc. 111, 726.)

CASE NOTES

Removal for Failure to Renew Bond. — A public administrator cannot be removed for failure to renew his bond without being notified to show cause. Trotter v. Mitchell, 115 N.C. 190, 20 S.E. 386 (1894), decided under prior law.

§ 28A-12-4. When public administrator shall apply for letters.

The public administrator shall apply for and may, with the approval of the clerk of superior court, obtain letters on the estates of decedents when:

(1) It is brought to his attention that a period of six months has elapsed from the death of any decedent who has died owning property, and no letters testamentary, or letters of administration or collection, have been applied for or issued to any person; or

(2) Any person without known heirs shall die intestate owning property; or

(3) Any person entitled to apply for letters of administration shall, in writing, request the clerk to issue letters to the public administrator as provided in G.S. 28A-5-2(c). (1868-9, c. 113, s. 6; Code, s. 1394; Rev., s. 20; C.S., s. 20; 1973, c. 1329, s. 3.)

Cross References. — As to renunciation of the right to administer, see G.S. 28A-5-2.

CASE NOTES

Editor's Note. — *Most of the cases below were decided under former Chapter 28 or law prior thereto.*

Public administrator acquires no rights or interest to administer an estate until he is qualified after the period allowed to the relatives to qualify in the order prescribed. In re Neal's Will, 182 N.C. 405, 109 S.E. 70 (1921).

Six Months Is Reasonable Time to Apply for Appointment of Administrator. — Six months after the death of testator is a reasonable time within which application should be made, in proper instances, for appointment of administrator c.t.a. In re Estate of Smith, 210 N.C. 622, 188 S.E. 202 (1936).

Prior Right of Others After Six Months. — While after the expiration of six months prior rights to administration may be deemed renounced and a public administrator appointed, yet even after six months, if he is not as yet appointed, persons of prior right to administration may be appointed in preference to him. In re Bailey's Will, 141 N.C. 193, 53 S.E. 844 (1906). See Hill v. Alspaugh, 72 N.C. 402 (1875).

After the expiration of six months, should the public administrator fail to apply, the field is open to the clerk of the superior court to treat all right of preference as renounced and to appoint, in the exercise of his discretion, some suitable person to administer the estate. Brooks v. E.H. Clement Co., 201 N.C. 768, 161 S.E. 403 (1931).

Cited in Baer v. Davis, 47 N.C. App. 581, 267 S.E.2d 581 (1980).

§ 28A-12-5. Powers and duties.

(a) The public administrator shall have, in respect to the several estates in his hands, all the rights and powers and shall be subject to all the duties and liabilities of other personal representatives.

(b) After the expiration of the term of office of a public administrator or his resignation as public administrator, he shall continue, subject to the provisions of Articles 9 and 10 of this Chapter, to administer the several estates previously committed to him until he has fully administered the same, and his bonds shall continue in effect as to all such estates. (1868-9, c. 113, s. 7; 1876-7, c. 239; Code, s. 1395; Rev., s. 21; C.S., s. 21; 1973, c. 1329, s. 3.)

CASE NOTES

Applied in City of Durham v. Hicks, 135 N.C. App. 699, 522 S.E.2d 583, 1999 N.C. App. LEXIS 1227 (1999).

§ 28A-12-6. Removal from office.

If letters of administration issued to the public administrator with respect to any estate are subsequently revoked on the grounds that they were obtained by false representation as provided in G.S. 28A-9-1(a)(2), or on the grounds as specified in G.S. 28A-9-1(a)(1), 28A-9-1(a)(3), 28A-9-2(a)(3), 28A-9-2(a)(5), or 28A-9-2(a)(6) or if he becomes a nonresident of the State, the clerk of superior court shall order the removal of the public administrator from office. (1973, c. 1329, s. 3.)

§ 28A-12-7. Procedure after removal from office.

The clerk of superior court shall require of any public administrator who is removed from office pursuant to G.S. 28A-12-6 a complete accounting of all his activities as public administrator and for the property remaining under his control by reason of his appointment under this Article as administrator of any estate that has not been fully administered at the time of his removal. If it appears to the clerk of superior court that grounds exist for revocation of letters of administration issued with respect to any such estate, he shall proceed in accordance with the provisions of Article 9 of this Chapter. If letters of administration are revoked pursuant to such proceedings, the clerk of superior court shall issue letters of administration to the successor public administrator or to some other person not disqualified under G.S. 28A-4-2. (1973, c. 1329, s. 3.)

§ 28A-12-8. Compensation.

A public administrator shall be compensated in accordance with Article 23 of this Chapter. (1977, c. 814, s. 5.)

Article 13.

Representative's Powers, Duties and Liabilities.

§ 28A-13-1. Time of accrual of duties and powers.

The duties and powers of a personal representative commence upon his or her appointment. The powers of a personal representative relate back to give acts by the person appointed which are beneficial to the estate occurring prior to appointment the same effect as those occurring thereafter. However, a person named executor in a will may, prior to appointment, carry out written instructions of the decedent relating to the decedent's body, funeral and burial arrangements; provided that a health care agent authorized in a valid health care power of attorney to make body, funeral, and burial arrangements shall have precedence in making these arrangements, both before and after qualification of the decedent's personal representative, to the extent provided in G.S. 32A-19(b). A personal representative may ratify and accept acts on behalf of the estate done by others where the acts would have been proper for a personal representative. (1973, c. 1329, s. 3; 2007-502, s. 17.)

Editor's Note. — Session Laws 2007-502, s. 18, provides: "The Legislative Research Commission shall study the issue of whether North Carolina law should be amended to allow a person to require life-prolonging measures. The LRC shall involve all stakeholders in the study. The LRC shall report its recommendations to the 2008 Session of the 2007 General Assembly."

Session Laws 2007-502, s. 19, provides: "The North Carolina Institute of Medicine (Institute) shall study issues related to the provision of end-of-life medical care in North Carolina. As part of the study, the Division of Health Service Regulation, Department of Health and Human Services, and the North Carolina Board of Medicine shall provide to the Institute nonidentifying information regarding claims and complaints related to end-of-life medical treatment by health care providers that was contrary to the express wishes of either the patient or a person authorized by law to make treatment decisions on behalf of the patient. The Institute may review any other data related to end-of-life medical care and treatment the Institute determines is relevant.

"The purpose of this study is to determine whether statutory changes related to advance directives and health care powers of attorney impact the type and quantity of end-of-life medical care provided to patients, whether the patient's or patient representative's express wishes regarding the provision of treatment at the end of life are being honored, and whether there is any change in the number of persons who request continued treatment at the end of their lives, but do not receive that treatment.

"The Institute shall report its findings to the following entities no later than January 30, 2013:

"(1) The 2013 General Assembly.

"(2) The North Carolina Bar Association.

"(3) The North Carolina Medical Society."

Effect of Amendments. — Session Laws 2007-502, s. 17, effective October 1, 2007, in the third sentence, inserted "However" at the beginning, moved "prior to appointment" from the beginning to the middle and inserted the proviso at the end and made gender neutral changes.

CASE NOTES

Claim Brought by Foreign Personal Representative Before Qualifying Locally. — Section 28A-26-6 neither addresses nor answers the question of what must happen procedurally to a claim brought by a foreign personal representative who locally qualifies after a claim brought by him is filed. Indeed, this section speaks more to this question. Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Whether a claim brought by a foreign personal representative before he is locally qualified must be dismissed and reinstituted or whether this defect can be cured by supplemental pleading in which the claim as instituted is duly ratified by the personal representative after he is locally qualified are questions which must be answered by reference to the principle codified in this section and to rules of pleading as set out in G.S. 1A-1, Rules 15 and 17(a). Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Testamentary directions for disposition of the testator's body must be treated as valid upon the death of the testator, and funeral directors who act upon the provision in good faith cannot later be held liable in tort because they acted before the will was probated. Dumouchelle v. Duke Univ., 69 N.C. App. 471, 317 S.E.2d 100 (1984).

A testamentary provision directing disposition of the testator's body must prevail over conflicting wishes of the testator's next-of-kin and the next-of-kin in such a case have no right to possession of the body for the purpose of selecting funeral arrangements and therefore they have no standing to sue for negligence for failure to carry out their instructions for disposal of testator's body. Dumouchelle v. Duke Univ., 69 N.C. App. 471, 317 S.E.2d 100 (1984).

Cited in Horne v. Owens-Corning Fiberglas Corp., 4 F.3d 276 (4th Cir. 1993).

§ 28A-13-2. General duties; relation to persons interested in estate.

A personal representative is a fiduciary who, in addition to the specific duties stated in this Chapter, is under a general duty to settle the estate of his decedent as expeditiously and with as little sacrifice of value as is reasonable under all of the circumstances. He shall use the authority and powers conferred upon him by this Chapter, by the terms of the will under which he is acting, by any order of court in proceedings to which he is party, and by the rules generally applicable to fiduciaries, for the best interests of all persons interested in the estate, and with due regard for their respective rights. (1973, c. 1329, s. 3.)

CASE NOTES

Applied in Holt v. Lynch, 307 N.C. 234, 297 S.E.2d 594 (1982).

Cited in Holt v. Lynch, 57 N.C. App. 532, 291 S.E.2d 920 (1982); In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-13-3. Powers of a personal representative or fiduciary.

(a) Except as qualified by express limitations imposed in a will of the decedent or a court order, and subject to the provisions of G.S. 28A-13-6 respecting the powers of joint personal representatives, a personal representative has the power to perform in a reasonable and prudent manner every act which a reasonable and prudent person would perform incident to the collection, preservation, liquidation or distribution of a decedent's estate so as to accomplish the desired result of settling and distributing the decedent's estate in a safe, orderly, accurate and expeditious manner as provided by law, including the powers specified in the following subdivisions:

(1) To take possession, custody or control of the personal property of the decedent. If in the opinion of the personal representative his possession, custody or control of such property is not necessary for purposes of administration, such property may be left with or surrendered to the heir or devisee presumptively entitled thereto. He has the power to take possession, custody or control of the real property of the decedent if he determines such possession, custody or control is in the best interest of the administration of the estate. Prior to exercising such power over real property the procedure as set out in subsection G.S. 28A-13-3(c) shall be followed. If the personal representative determines that such possession, custody or control is not in the best interest of the administration of the estate such property may be left with or surrendered to the heir or devisee presumptively entitled thereto.

(2) To retain assets owned by the decedent pending distribution or liquidation even though such assets may include items which are otherwise improper for investment of trust funds.

(3) To receive assets from other fiduciaries or other sources.

(4) To complete performance of contracts entered into by the decedent that continue as obligations of his estate, or to refuse to complete such contracts, as the personal representative may determine to be in the best interests of the estate, but such refusal shall not limit any cause of action which might have been maintained against decedent if he had refused to complete such contract. In respect to enforceable contracts by the decedent to convey an interest in land, the provisions of G.S. 28A-17-9 are controlling.

(5) To deposit, as a fiduciary, funds of the estate in a bank, including a bank operated by the personal representative pursuant to G.S. 53-163.1.

(6) To make, as a fiduciary, any form of investment allowed by law to the State Treasurer under G.S. 147-69.1, with funds of the estate, when such are not needed to meet debts and expenses immediately payable and are not immediately distributable, including money received from the sale of other assets; or to enter into other short-term loan arrangements that may be appropriate for use by trustees or beneficiaries generally. Provided, that in addition to the types of investments hereby authorized, deposits in interest-bearing accounts of any credit union authorized to do business in this State, when such deposits are insured in the same manner as required by G.S. 147-69.1 for deposits in a savings and loan association, are hereby authorized.

(7) To abandon or relinquish all rights in any property when, in the opinion of the personal representative acting reasonably and in good faith, it is valueless, or is so encumbered or is otherwise in such condition that it is of no benefit to the estate.

(8) To vote shares of stock or other securities in person or by general or limited proxy, and to execute waivers, consents or objections with respect to such stock or securities.

(9) To pay calls, assessments, and any other sums chargeable or accruing against or on account of securities.

(10) To hold shares of stock or other securities in the name of a nominee, without mention of the estate in the instrument representing stock or other securities or in registration records of the issuer thereof; provided, that

a. The estate records and all reports or accounts rendered by the personal representative clearly show the ownership of the stock or other securities by the personal representative and the facts regarding its holdings, and

b. The nominee shall not have possession of the stock or other securities or access thereto except under the immediate supervision of the personal representative or when such securities are deposited by the personal representative in a clearing corporation as defined in G.S. 25-8-102.

Such personal representative shall be personally liable for any acts or omissions of such nominee in connection with such stock or other securities so held, as if such personal representative had done such acts or been guilty of such omissions.

(11) To insure, at the expense of the estate, the assets of the estate in his possession, custody or control against damage or loss.

(12) To borrow money for such periods of time and upon such terms and conditions as to rates, maturities, renewals, and security as the

personal representative shall deem advisable, including the power of a corporate personal representative to borrow from its own banking department, for the purpose of paying debts, taxes, and other claims against the estate, and to mortgage, pledge or otherwise encumber such portion of the estate as may be required to secure such loan or loans. In respect to the borrowing of money on the security of the real property of the decedent, G.S. 28A-17-11 is controlling.

(13) To renew obligations of the decedent for the payment of money.

(14) To advance his own money for the protection of the estate, and for all expenses, losses and liabilities sustained in the administration of the estate or because of the holding or ownership of any estate assets. For such advances, with any interest, the personal representative shall have a lien on the assets of the estate as against a devisee or heir.

(15) To compromise, adjust, arbitrate, sue on or defend, abandon, or otherwise deal with and settle claims in favor of or against the estate.

(16) To pay taxes, assessments, his own compensation, and other expenses incident to the collection, care, administration and protection of the assets of the estate in his possession, custody or control.

(17) To sell or exercise stock subscription or conversion rights; consent, directly or through a committee or other agent, to the reorganization, consolidation, merger, dissolution, or liquidation of a corporation or other business enterprise.

(18) To allocate items of income or expense to either estate income or principal, as permitted or provided by law.

(19) To employ persons, including attorneys, auditors, investment advisors, appraisers or agents to advise or assist him in the performance of his administrative duties.

(20) To continue any business or venture in which the decedent was engaged at the date of his death, where such continuation is reasonably necessary or desirable to preserve the value, including goodwill, of the decedent's interest in such business. With respect to the use of the decedent's interest in a continuing partnership, the provisions of G.S. 59-71 and 59-72 qualify this power; and with respect to farming operations engaged in by the decedent at the time of his death, the provisions of G.S. 28A-13-4 qualify this power.

(21) To incorporate or participate in the incorporation of any business or venture in which the decedent was engaged at the time of his death.

(22) To provide for the exoneration of the personal representative from personal liability in any contract entered into on behalf of the estate.

(23) To maintain actions for the wrongful death of the decedent according to the provisions of Article 18 of this Chapter and to compromise or settle any such claims, whether in litigation or not. Unless all persons who would be entitled to receive any damages recovered under G.S. 28A-18-2(b)(4) are competent adults and have consented in writing, any such settlement shall be subject to the approval of a judge of the court or tribunal exercising jurisdiction over the action or a judge of the district or superior court in cases where no action has previously been filed. If the claim is brought under Article 31 of Chapter 143 of the General Statutes, the settlement is subject to the approval of the Industrial Commission in accordance with that Article. It shall be the duty of the personal representative in distributing the proceeds of such settlement in any instance to take into consideration and to make a fair allocation to those claimants for funeral, burial, hospital and medical expenses which would have been payable from damages which might have been recovered had a wrongful death action gone to judgment in favor of the plaintiff.

(24) To maintain any appropriate action or proceeding to recover possession of any property of the decedent, or to determine the title thereto; to recover damages for any injury done prior to the death of the decedent to any of his property; and to recover damages for any injury done subsequent to the death of the decedent to such property.

(25) To purchase at any public or private sale of any real or personal property belonging to the decedent's estate or securing an obligation of the estate as a fiduciary for the benefit of the estate when, in his opinion, it is necessary to prevent a loss to the estate.

(26) To sell or lease personal property of the estate in the manner prescribed by the provisions of Article 16 of this Chapter.

(27) To sell or lease real property of the estate in the manner prescribed by the provisions of Article 17 of this Chapter.

(28) To enter into agreements with taxing authorities to secure the benefit of the federal marital deduction pursuant to G.S. 28A-22-6.

(29) To pay or satisfy the debts and claims against the decedent's estate in the order and manner prescribed by Article 19 of this Chapter.

(30) To distribute any sum recovered for the wrongful death of the decedent according to the provisions of G.S. 28A-18-2; and to distribute all other assets available for distribution according to the provisions of this Chapter or as otherwise lawfully authorized.

(31) To exercise such additional lawful powers as are conferred upon him by the will.

(32) To execute and deliver all instruments which will accomplish or facilitate the exercise of the powers vested in the personal representative.

(33) To renounce in accordance with the provisions of Chapter 31B of the General Statutes.

(a1) Except as qualified by express limitations imposed in a will of the decedent, and subject to the provisions of G.S. 28A-13-6 respecting the powers of joint personal representatives, a personal representative shall have absolute discretion to make the election as to which items of the decedent's personal and household effects shall be excluded from the carry over basis provision of the federal income tax law and such election shall be conclusive and binding on all concerned.

(b) Any question arising out of the powers conferred by subsections (a) and (a1) above shall be determined in accordance with the provisions of Article 18 of this Chapter.

(c) Prior to the personal representative exercising possession, custody or control over real property of the estate he shall petition the clerk of court to obtain an order authorizing such possession, custody or control. The petition shall include:

(1) A description of the real property which is the subject of the petition;

(2) The names, ages, and addresses, if known, of the devisees and heirs of the decedent;

(3) A statement by the personal representative that he has determined that such possession, custody or control is in the best interest of the administration of the estate.

The devisees and heirs will be made parties to the proceeding by service of summons in the manner prescribed by law. If the clerk of court determines that it is in the best interest of the administration of the estate to authorize the personal representative to take possession, custody or control he shall grant an order authorizing that power. If a special proceeding has been instituted by the personal representative pursuant to G.S. 28A-15-1(c), the personal representative may petition for possession, custody, or control of any real property as a part of that proceeding and is not required to institute a separate special

proceeding. (1868-9, c. 113, ss. 73, 77; Code, ss. 1501, 1505; Rev., ss. 85, 159; C.S., ss. 170, 171; 1925, c. 86; 1933, cc. 161, 196, 498; 1973, c. 1329, s. 3; 1975, c. 19, s. 9; c. 371, s. 4; 1977, c. 556; 1979, c. 467, s. 21; c. 717, s. 3; 1985, c. 689, s. 8; 1991, c. 460, s. 3; 1995, c. 401, s. 1; 1997-181, s. 22; 2001-413, s. 2; 2002-159, s. 8; 2007-106, s. 1.)

Local Modification. — City of Winston-Salem: 1995, c. 112, s. 1.

Editor's Note. — Session Laws 2007-106, s. 56, provides: "This act becomes effective October 1, 2007, and applies to (i) all trusts created, and to all conveyances, devises, beneficiary designations, or other transfers occurring before, on, or after that date; (ii) all judicial proceedings concerning trusts or transfers to or by trusts commenced on or after that date; and (iii) all judicial proceedings concerning trusts or transfers to or by trusts commenced before that date unless the court finds that application of a particular provision of this act would substantially interfere with the effective conduct of the judicial proceedings or prejudice the rights of the parties, in which case the law as it existed on September 30, 2007, shall apply."

Effect of Amendments. — Session Laws 2007-106, s. 1, effective October 1, 2007, in subsection (a), substituted "person" for "man" near the middle and deleted "but not limited to" preceding "the powers specified" near the end; and substituted "pursuant to G.S. 53-163.1." for "upon compliance with the provisions of G.S. 36A-63" at the end of subdivision (a)(5). See Editor's note for applicability.

CASE NOTES

Recovery of Realty by Administrator De Bonis Non, Cum Testamento Annexo. — Where an executor is entitled to the possession of the land, his successor, an administrator de bonis non, cum testamento annexo, is entitled to the same rights and remedies as his predecessor in office. Smathers v. Moody, 112 N.C. 791, 17 S.E. 532 (1893), decided under prior law.

Authority to Execute Lease. — A person who executes a lease as executor of an estate and represents to the lessee that he has authority to do so is not personally liable for a breach of the lease when an examination of the will on record would have revealed the executor did not have authority to execute the lease. Trull v. McIntyre, 48 N.C. App. 599, 269 S.E.2d 308, cert. denied, 301 N.C. 531, 273 S.E.2d 463 (1980).

No Authority to Waive Attorney-Client Privilege. — Deceased client's widow did not have the authority, as his personal representative, under G.S. 28A-13-3(a)(15), to waive his attorney-client privilege, by reopening his estate "to handle legal matters," as it was not plausible that she reopened the estate in consideration of the estate's release from civil liability given by the family of an individual whose murder investigation the client was involved in when he committed suicide, as the release stated it was in consideration for the sum of one dollar and did not mention an affidavit the widow executed purporting to waive the client's attorney-client privilege, and the estate had no assets when it was reopened. In re Investigation of the Death of Miller, 357 N.C. 316, 584 S.E.2d 772, 2003 N.C. LEXIS 831 (2003).

No Conflict Between § 97-10.2(f)(1) and Subdivision (a)(23) of This Section. — Section 97-10.2(f)(1) addresses solely the distribution of proceeds of, inter alia, a wrongful death settlement, whereas subdivision (a)(23) of this section controls the manner in which a wrongful death action may be settled by an administrator. There is thus no conflict between the statutes, fairly and properly construed, and each remains effective in its respective area of application. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

Jurisdiction over Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against her based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Subdivision (a)(23) of this section specifically addresses settlement of wrongful death claims and is thus controlling, even where an administrator's actions may also be characterized as abandonment of a claim by the estate within the more general language of subdivision (a)(15) of this section. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

Prior Settlement and Approval of Attorneys' Fees Not Bar to Malpractice Suit. — Settlement and approval of attorneys' fees in previous wrongful death action was not a bar to suit for attorney malpractice alleging negligence and breach of fiduciary duty; collateral estoppel was not applicable so as to support summary judgment in favor of defendants. Beckwith v. Llewellyn, 326 N.C. 569, 391 S.E.2d 189 (1990).

Personal representative has the authority, in accomplishing the expeditious settlement of a decedent's estate, to settle and compromise claims in favor of or against the estate, provided that he acts honestly, reasonably and prudently. Hunter v. Newsom, 121 N.C. App. 564, 468 S.E.2d 802 (1996).

In the determination of whether a deed of trust conveyed by the executor is a debt of the estate, the burden is on the party asserting the validity of the debt as an obligation of the estate to show that the executor acted within his authority as executor. Hunter v. Newsom, 121 N.C. App. 564, 468 S.E.2d 802 (1996).

Applied in Holt v. Lynch, 307 N.C. 234, 297 S.E.2d 594 (1982); State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 614 (2000).

Cited in Montgomery v. Hinton, 45 N.C. App. 271, 262 S.E.2d 697 (1980); Terry v. Terry, 302 N.C. 77, 273 S.E.2d 674 (1981); Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447 (1988); Severance v. Ford Motor Co., 98 N.C. App. 330, 390 S.E.2d 704 (1990); Beckwith v. Llewellyn, 326 N.C. 569, 391 S.E.2d 189 (1990); Horne v. Owens-Corning Fiberglas Corp., 4 F.3d 276 (4th Cir. 1993); McInnis v. Provident Life & Accident Ins. Co., 21 F.3d 586 (4th Cir. 1994); Farm Credit Bank v. Edwards, 121 N.C. App. 72, 464 S.E.2d 305 (1995); State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 538 (2000); Olvera v. Edmundson, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 15284 (W.D.N.C. Sept. 21, 2001); Beyer v. N.C. Div. of Mental Health, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 16968 (W.D.N.C. Oct. 16, 2001).

§ 28A-13-4. Continuance of farming operations of deceased persons.

When any person dies while engaged in farming operations, his personal representative is authorized to continue such farming operations until the end of the current calendar year, and until all crops grown during that year are harvested. The net income from such farming operations shall be personal assets of the estate. Any indebtedness incurred in connection with such farming operations after the date of death shall be preferred over the claims of any heir, legatee, devisee, distributee, general or unsecured creditor of said estate. Nothing herein contained shall limit the powers of a personal representative under the terms of a will. (1935, c. 163; 1973, c. 1329, s. 3.)

§ 28A-13-5. Personal representatives hold in joint tenancy.

Any estate or interest in property which becomes vested in two or more personal representatives shall be held by them in joint tenancy with the incident of survivorship. (1868-9, c. 113, s. 74; Code, s. 1502; Rev., s. 166; C.S., s. 172; 1973, c. 1329, s. 3.)

CASE NOTES

Cited in Trull v. McIntyre, 48 N.C. App. 599, 269 S.E.2d 308 (1980).

§ 28A-13-6. Exercise of powers of joint personal representatives by one or more than one.

(a) Repealed by Session Laws 2005-192, s. 5, effective January 1, 2006.

(b) If a will expressly makes provision for the execution of any of the powers of personal representatives by all of them or by any one or more of them, the provisions of the will govern.

(c) Repealed by Session Laws 2005-192, s. 5, effective January 1, 2006.

(c1) If there is no governing provision in the will, personal representatives may, by written agreement signed by all of them and filed with and approved by the clerk of superior court of the county in which the personal representatives qualified, provide that any designated one or more of the personal representatives may exercise one or more of the following powers:

(1) Establish and maintain bank accounts for the trust and issue checks for the estate.
(2) Maintain inventories, accountings, and income and expense records of the estate.
(3) Enter any safety deposit box rented by the estate.
(4) Employ persons as advisors or assistants in the performance of administrative duties, including agents, attorneys, accountants, brokers, appraisers, and custodians.
(5) List estate property for taxes and prepare and file tax returns for the trust.
(6) Collect and give receipts for claims and debts of the estate.
(7) Pay debts, claims, costs of administration, and taxes of the estate.
(8) Compromise, adjust, or otherwise settle any claim by or against the trust and release, in whole or in part, a claim belonging to the estate.
(9) Have custody of the estate property.
(10) Perform any function relating to investment of estate assets.

(d) Subject to subsection (b) of this section, if two or more personal representatives own shares of corporate stock or other securities, their acts with respect to voting shall have the following effect:

(1) If only one votes, in person or by proxy, that personal representative's act binds all;
(2) If more than one vote, in person or by proxy, the act of the majority so voting binds all;
(3) If more that one vote, in person or by proxy, but the vote is evenly split on any particular matter, each faction is entitled to vote the stock or other securities in question proportionately.

(e) Subject to subsections (b), (c1), and (d) of this section, all other acts and duties must be performed by both of the personal representatives if there are two, and by a majority of them if there are more than two. No personal representative who has not joined in exercising a power shall be liable for the consequences of such exercise, nor shall a dissenting personal representative be liable for the consequences of an act in which the personal representative joins at the direction of the majority of the personal representatives, if that personal representative expressed his or her dissent in writing to any other personal representative at or before the time of such joinder.

(f) No personal representative shall be relieved of liability on his or her bond or otherwise by entering into any agreement under this section. (1959, c. 1160; 1973, c. 1329, s. 3; 1977, c. 446, s. 1; 1991, c. 460, s. 1; 2005-192, s. 5.)

Effect of Amendments. — Session Laws 2005-192, s. 5, effective January 1, 2006, repealed subsections (a) and (c); added subsection (c1); in subdivision (d)(1), substituted "that personal representative's act" for "his act"; in subsection (e), substituted "Subject to subsections (b), (c1), and (d)" for "Subject to the provisions of subsections (b), (c) and (d)" in the first sentence, substituted "the personal representative joins" for "he joins" and substituted "that personal representative expressed his or her dissent" for "he expressed his dissent" in the second sentence; and inserted "or her" in subsection (f).

CASE NOTES

Cited in Trull v. McIntyre, 48 N.C. App. 599, 269 S.E.2d 308 (1980).

§ 28A-13-7. Powers and duties of successor personal representative.

A successor personal representative is one appointed to succeed a personal representative whose appointment has terminated by death, resignation or revocation. Unless a contrary intent clearly appears from the will, a successor personal representative has all the powers and duties, discretionary or otherwise, of the original personal representative. (1973, c. 1329, s. 3.)

§ 28A-13-8. Powers and duties of administrator with will annexed.

When an administrator with the will annexed has been appointed, whether or not he is succeeding a previously appointed personal representative, he has the same powers and duties, discretionary or otherwise, as if he had been named executor in the will, unless a contrary intent clearly appears from the will. (C.C.P., s. 468; 1870-1, c. 93; Code, s. 1388; Rev., s. 319; C.S., s. 33; 1935, c. 386; 1949, c. 971; 1967, c. 41, s. 1; 1973, c. 1329, s. 3.)

§ 28A-13-9. Powers of surviving personal representative.

When one or more of those nominated as coexecutors in a will is not appointed, or when the appointment of one or more joint personal representatives is terminated, every power granted to such joint personal representatives may be exercised by the surviving representative or representatives; provided that nothing to the contrary appears in the will of a testate decedent. (C.C.P., s. 451; Code, s. 2164; Rev., s. 13; C.S., s. 16; 1931, c. 183; 1953, c. 78, s. 1; 1973, c. 1329, s. 3.)

CASE NOTES

Sale by One of Joint Executors. — If one of the joint executors fails to qualify, a sale of lands by the one qualifying is sufficient to pass the estate, without its appearing that the other either has renounced the executorship or refused to join in the sale. Wood v. Sparks, 18 N.C. 389 (1835), decided under prior law.

§ 28A-13-10. Liability of personal representative.

(a) Property of Estate. — A personal representative shall be liable for and chargeable in his accounts with all of the estate of the decedent which comes into his possession at any time, including all the income therefrom; but he shall not be liable for any debts due to the decedent or other assets of the estate which remain uncollected without his fault. Except for commissions allowable by law, he shall not be entitled to any profits caused by an increase in values, nor be chargeable with loss by a decrease in value or destruction without his fault, of any part of the estate.

(b) Property Not a Part of Estate. — A personal representative shall be chargeable in his accounts with property not a part of the estate which comes into his possession at any time and shall be liable to the persons entitled thereto if:

(1) The property was received under a duty imposed on him by law in the capacity of personal representative; or

(2) He has commingled such property with the assets of the estate.

(c) Breach of Duty. — A personal representative shall be liable and chargeable in his accounts for any loss to the estate arising from his embezzlement or commingling of the estate with other property; for loss to the estate through self-dealing; for any loss to the estate from wrongful acts or omissions of his joint personal representatives which he could have prevented by the exercise of ordinary care; and for any loss to the estate arising from his failure to act in good faith and with such care, foresight and diligence as an ordinarily reasonable and prudent man would act with his own property under like circumstances. If the exercise of power concerning the estate is improper, the personal representative is liable for breach of fiduciary duty to interested persons for resulting damage or loss to the same extent as a trustee of an express trust. (1973, c. 1329, s. 3; 1975, c. 300, s. 4.)

Legal Periodicals. — For survey of 1982 law on property, see 61 N.C.L. Rev. 1171 (1983).

CASE NOTES

Liability for Depreciation of Assets. — An executor, in performing those duties related to managing the estate's assets, acts as a trustee to beneficiaries of the estate. As such, the executor is liable for the depreciation of assets which an ordinarily prudent fiduciary would not have allowed to occur. Fortune v. First Union Nat'l Bank, 87 N.C. App. 1, 359 S.E.2d 801 (1987), rev'd on other grounds, 323 N.C. 146, 371 S.E.2d 483 (1988).

Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against her based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Cited in Tyson v. North Carolina Nat'l Bank, 305 N.C. 136, 286 S.E.2d 561 (1982).

Article 14.

Notice to Creditors.

§ 28A-14-1. Notice for claims.

(a) Every personal representative and collector after the granting of letters shall notify all persons, firms and corporations having claims against the decedent to present the same to such personal representative or collector, on or before a day to be named in such notice, which day must be at least three months from the day of the first publication or posting of such notice. The notice shall set out a mailing address for the personal representative or collector. The notice shall be published once a week for four consecutive weeks in a newspaper qualified to publish legal advertisements, if any such newspaper is published in the county. If there is no newspaper published in the county, but there is a newspaper having general circulation in the county, then at the option of the personal representative, or collector, the notice shall be published once a week for four consecutive weeks in the newspaper having general circulation in the county and posted at the courthouse or the notice shall be posted at the courthouse and four other public places in the county. Personal representatives are not required to publish or mail notice to creditors if the only asset of the estate consists of a claim for damages arising from death by wrongful act. When any collector or personal representative of an estate has published or mailed the notice provided for by this section, no further publication or mailing shall be required by any other collector or personal representative.

(b) Prior to filing the proof of notice required by G.S. 28A-14-2, every personal representative and collector shall personally deliver or send by first class mail to the last known address a copy of the notice required by subsection (a) of this section to all persons, firms, and corporations having unsatisfied claims against the decedent who are actually known or can be reasonably ascertained by the personal representative or collector within 75 days after the granting of letters. Provided, however, no notice shall be required to be delivered or mailed with respect to any claim that is recognized as a valid claim by the personal representative or collector.

(c) The personal representative or collector may personally deliver or mail by first class mail a copy of the notice required by subsection (a) of this section to all creditors of the estate whose names and addresses can be ascertained with reasonable diligence. If the personal representative or collector in good faith believes that the notice required by subsection (b) of this section to a particular creditor is or may be required and gives notice based on that belief, the personal representative or collector is not liable to any person for giving the notice, whether or not the notice is actually required by subsection (b) of this section. If the personal representative or collector in good faith fails to give notice required by subsection (b) of this section, the personal representative or collector is not liable to any person for such failure. (1868-9, c. 113, s. 29; 1881, c. 278, s. 2; Code, ss. 1421, 1422; Rev., s. 39; C.S., s. 45; 1945, c. 635; 1949, c. 47; c. 63, s. 1; 1955, c. 625; 1961, c. 26, s. 1; c. 741, s. 1; 1973, c. 1329, s. 3; 1977, c. 446, s. 1; 1985, c. 319; 1987 (Reg. Sess., 1988), c. 1077, s. 1; 1989, c. 378, s. 1; c. 770, s. 8; 1991, c. 282, s. 1.)

Cross References. — As to cost of publication, see G.S. 1-596.

Legal Periodicals. — For article, "Notice to Creditors in Estate Proceedings: What Process Is Due?", see 63 N.C.L. Rev. 659 (1985).

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Time of Presenting Claims. — Before distribution of the estate, it is the duty of the administrator to pay the debts of the estate, provided such debts are presented within 12 months (now three months) next after publication under this section. As against claims presented after that period he will not be chargeable with any distribution he may have made in good faith. Mallard v. Patterson, 108 N.C. 255, 13 S.E. 93 (1891).

Shareholders Not Entitled to Personal Notice. — Contrary to shareholders' argument, the record was clear that the executrix did not have knowledge of any unsatisfied claim against the testator or the estate, and the shareholders had settled and dismissed an earlier suit against testator without prejudice, and never served a second suit; the shareholders therefore were not entitled to personal notice. In re Estate of Mullins, — N.C. App. —, 643 S.E.2d 599, 2007 N.C. App. LEXIS 798 (2007).

Action Following Tortfeasor's Death Not Time Barred. — Action filed on October 20, 2000, two days after qualification of deceased driver's personal representative, for personal injuries arising out of an automobile accident that occurred on June 27, 1997, was not barred by G.S. 1-52, where deceased died on November 7, 1997, at which time the three year limitations period had not yet expired, as under G.S. 28A-18-1 plaintiff's cause of action survived his death, and thus, pursuant to G.S. 1-22, plaintiff was permitted to commence a cause of action against deceased's personal representative, provided that either the action was brought within the time specified for the presentation of claims in G.S. 28A-19-3, or that notice of the claim upon which the action was based was presented to the personal representative within the time specified for the presentation of claims in G.S. 28A-19-3. The personal representative's failure to establish in the record that she complied with G.S. 28A-19-3(a) regarding general notice to creditors precluded her from relying upon the statute of limitations as a bar; moreover, under G.S. 28A-14-1(a), the absolute earliest "deadline" date which could have been specified by the personal representative in the general notice to creditors was January 18, 2001, three months from the day of the first publication or posting of such notice. Mabry v. Huneycutt, 149 N.C. App. 630, 562 S.E.2d 292, 2002 N.C. App. LEXIS 271 (2002).

Advertisement Essential to Bar Claims. — The mere lapse of time does not bar the creditors' claims against the estate. Only where the advertisement provided under this section has been made does the statute of limitation begin to run. Love v. Ingram, 104 N.C. 600, 10 S.E. 77 (1889). But see Morissey v. Hill, 142 N.C. 355, 55 S.E. 193 (1906), where it was held that this section was enacted more for the protection of the representative, and hence a claim would be barred independent of whether the advertisement provided by the section was published or not. To the same effect, see also Andres v. Powell, 97 N.C. 155, 2 S.E. 235 (1887).

Where the administrator neither avers nor proves that he gave the notice required by this section, the objection that the creditor has not shown that he ever presented his claim will not avail. Valentine v. Britton, 127 N.C. 57, 37 S.E. 74 (1900). See Love v. Ingram, 104 N.C. 600, 10 S.E. 77 (1889). But see Morissey v. Hill, 142 N.C. 355, 55 S.E. 193 (1906).

Notice Held Fatally Defective. — An executor's general notice to creditors published in a newspaper was fatally defective where it failed to name a day after which claims would be barred and failed to give notice that claims must be filed within six months (now three months) from the day of the first publication of the notice; therefore, the notice to creditors was ineffective to start the running of the statute of limitations of G.S. 28A-19-3(a) in bar of a claim against decedent's estate to recover for personal injuries received in an automobile accident. Anderson v. Gooding, 300 N.C. 170, 265 S.E.2d 201 (1980).

Claims Against the Estate for Decedent's Fraud Barred. — Where plaintiff's claims were based on fraud, and one participant in the fraud was dead, two statutes were applicable to their action, G.S. 1-52(9) requiring a claim be filed within three years of the discovery of the fraud, and this section requiring that a claim be filed within six months after the personal representative of the decedent first published the notice to creditors. Since this section more specifically deals with when a claim may be filed against an estate, this statute controlled, and would bar a cause of action even if the action had been filed within three years of discovery. Liner v. DiCresce, 905 F. Supp. 280 (M.D.N.C. 1994).

For the purpose of the discovery rule delaying the running of a limitation period, a subtle yet distinct difference in meaning between the words "arise" and "accrue" becomes evident: a cause of action for fraud accrues when the fraud is discovered. Because a participant in fraud died more than four years before action was filed, any alleged fraud committed by him must have arisen more than four years earlier, during his lifetime, and the North Carolina nonclaim statute barred any claims filed more than six months after final creditor's notice, though sounding in fraud. Liner v. DiCresce, 905 F. Supp. 280 (M.D.N.C. 1994).

Cited in Carethers v. Blair, 53 N.C. App. 233, 280 S.E.2d 467 (1981); Lassiter v. Faison, 111 N.C. App. 206, 432 S.E.2d 373 (1993); Pierce v. Johnson, 154 N.C. App. 34, 571 S.E.2d 661, 2002 N.C. App. LEXIS 1406 (2002).

§ 28A-14-1.1. Validation of certain notices.

(a) Any notice to creditors published or posted under G.S. 28A-14-1 which did not, in the advertisement, name the day after which claims could not be presented is validated.

(b) This section applies to all notices published and posted between October 1, 1975, and January 1, 1991, except that it does not affect any pending litigation or any litigation instituted within 90 days of January 1, 1991. (1981, c. 96, ss. 1, 2; 1987, c. 277, s. 8; 1989, c. 390, s. 8; 1991, c. 489, s. 8.)

§ 28A-14-2. Proof of notice.

A copy of the notice directed by G.S. 28A-14-1(a) to be posted or published, together with an affidavit or affidavits of one of the persons authorized by G.S. 1-600(a) to make affidavits to the effect that such notice was posted or published in accordance with G.S. 28A-14-1(a), and an affidavit of the personal representative or collector, or the attorney for the personal representative or collector, to the effect that a copy of the notice was personally delivered or mailed to each creditor entitled to notice in accordance with G.S. 28A-14-1(b) shall be filed in the office of the clerk of superior court by the personal representative or collector at the time the inventory required by G.S. 28A-20-1 is filed. The copy of the notice, together with the affidavit or affidavits, shall be deemed a record of the court and a copy thereof, duly certified by the clerk of superior court, shall be received as prima facie evidence of the fact of publication or mailing in all the courts of this State. (1868-9, c. 113, s. 31; Code, s. 1423; Rev., s. 40; C.S., s. 46; 1951, c. 1005, s. 3; 1961, c. 26, s. 2; 1973, c. 1329, s. 3; 1987 (Reg. Sess., 1988), c. 1077, s. 2; 1989, c. 378, s. 2.)

CASE NOTES

Necessity of Proof. — When an administrator pleads to a bill the provision of law which prescribes the time of bringing suits against him, he is bound to show by proof that he advertised as required by the statute. Gilliam v. Willey, 54 N.C. 128 (1853), decided under prior law; Anderson v. Gooding, 300 N.C. 170, 265 S.E.2d 201 (1980).

§ 28A-14-3. Personal notice to creditor.

The personal representative or collector may cause the notice to be personally served on any creditor. (1868-9, c. 113, s. 32; Code, s. 1424; 1885, c. 96; Rev., s. 41; C.S., s. 47; 1961, c. 741, s. 2; 1973, c. 1329, s. 3; 1977, c. 446, s. 1; c. 798; 1979, c. 509, s. 2.)

CASE NOTES

Applied in Thorpe v. Wilson, 58 N.C. App. 292, 293 S.E.2d 675 (1982).

Cited in Anderson v. Gooding, 43 N.C. App. 611, 259 S.E.2d 398 (1979); Carethers v. Blair, 53 N.C. App. 233, 280 S.E.2d 467 (1981).

Article 15.

Assets; Discovery of Assets.

§ 28A-15-1. Assets of the estate generally.

(a) All of the real and personal property, both legal and equitable, of a decedent shall be assets available for the discharge of debts and other claims against his estate in the absence of a statute expressly excluding any such property. Provided that before real property is selected the personal representative must determine that such selection is in the best interest of the administration of the estate.

(b) In determining what property of the estate shall be sold, leased, pledged, mortgaged or exchanged for the payment of the debts of the decedent and other claims against his estate, the personal representative shall select the assets which in his judgment are calculated to promote the best interests of the estate. In the selection of assets for this purpose, there shall be no necessary distinction between real and personal property, absent any contrary provision in the will.

(c) If it shall be determined by the personal representative that it is in the best interest of the administration of the estate to sell, lease, or mortgage any real estate or interest therein to obtain money for the payment of debts and other claims against the decedent's estate, the personal representative shall institute a special proceeding before the clerk of superior court for such purpose pursuant to Article 17 of this Chapter, except that no such proceeding shall be required for a sale made pursuant to authority given by will. A general provision granting authority to the personal representative to sell the testator's real property, or incorporation by reference of the provisions of G.S. 32-27(2) shall be sufficient to eliminate the necessity for a proceeding under Article 17. If a special proceeding has been instituted by the personal representative pursuant to G.S. 28A-13-3(c), the personal representative may petition for sale, lease, or mortgage of any real property as a part of that proceeding and is not required to institute a separate special proceeding.

(d) The crops of every deceased person, remaining ungathered at his death, shall, in all cases, belong to the personal representative or collector, as part of the personal assets of the decedent's estate; and shall not pass to the devisee by virtue of any devise of the land, unless such intent be manifest and specified in the will. (1868-9, c. 113, ss. 14, 15; Code, ss. 1406, 1407; Rev., ss. 45, 47; C.S., ss. 52, 54; 1973, c. 1329, s. 3; 1975, c. 300, s. 5; 1985, c. 426; 2001-413, s. 2.1; 2002-159, s. 9.)

Legal Periodicals. — See legislative survey, 21 Campbell L. Rev. 323 (1999).

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

All the chattels of an intestate are assets, if the administrator by reasonable diligence might have possessed himself of them. Gray v. Swain, 9 N.C. 15 (1822).

Lands as Assets. — Land is not an asset until it is sold and the proceeds received by the personal representative. Fike v. Green, 64 N.C. 665 (1870); Edenton v. Wool, 65 N.C. 379 (1871); Hawkins v. Carpenter, 88 N.C. 403 (1883); Wilson v. Bynum, 92 N.C. 717 (1885).

Automobile Liability Policies as Assets. — Automobile liability policies are not expressly excluded by any statute from being included as an asset in an a estate; they are therefore resources available for the satisfaction of claims against the estate arising from decedent's ownership and operation of an automobile while he was alive. Carethers v. Blair, 53 N.C. App. 233, 280 S.E.2d 467 (1981).

The direction from the testator that certain property in the estate not be applied to payment of estate liabilities cannot operate to prevent payment of debts, taxes and costs of administration which are justly owed. Combs v. Eller, 30 N.C. App. 30, 226 S.E.2d 197 (1976).

In the determination of whether a deed of trust conveyed by the executor is a debt of the estate, the burden is on the party asserting the validity of the debt as an obligation of the estate to show that the executor acted within his authority as executor. Hunter v. Newsom, 121 N.C. App. 564, 468 S.E.2d 802 (1996).

Rents Liable for Debts. — The rents on devised land may be subjected by the personal representative to the payment of the debts of deceased. Shell v. West, 130 N.C. 171, 41 S.E. 65 (1902).

Rent Accruing Before and After Death. — Rent due for the occupation of an equitable estate in land, in the lifetime of the cestui que trust, goes to his personal representative, that accruing after his death goes to his heirs. Fleming v. Chunn, 57 N.C. 422 (1859); Rogers v. McKenzie, 65 N.C. 218 (1871).

Warrant for Pension Is Not Asset. — A warrant for a pension issued after the death of the pensioner does not become a part of his assets, but must be returned to the State for cancellation. In re Smith, 130 N.C. 638, 41 S.E. 802 (1902).

Nor Is Recovery for Death by Wrongful Act. — The right to recover damages for wrongful death rests entirely on statute, and when a recovery is had therefor it is not a part of the personal assets of the deceased. Hood v. American Tel. & Tel. Co., 162 N.C. 92, 77 S.E. 1094 (1913).

Damages for wrongful death when recovered are not assets of the estate available to creditors. Hines v. Foundation Co., 196 N.C. 322, 145 S.E. 612 (1928).

Ownership of Note upon Death of Joint Payee. — Promissory note payable only to testator and his wife did not become part of testator's estate but became the sole property of testator's wife upon his death; therefore, son would not inherit. Miller v. Miller, 117 N.C. App. 71, 450 S.E.2d 15 (1994).

Homestead Exemptions. — The personal exemptions in N.C. Const., Art. X exist only during the life of the "homesteader," and after his death pass to his personal representative, to be disposed of in due course of administration. Johnson v. Cross, 66 N.C. 167 (1872).

The principle of subsection (d) is declaratory of the common law. See Flynt v. Conrad, 61 N.C. 190 (1867).

Subsection (d) does not control the title to crops not planted at the time of the death of the testator or devisor. Manifestly, in the forum of common sense, a crop could not be a crop until the seeds were in the soil. The statute uses the expression, "crops . . . remaining ungathered at his death," etc. An ungathered crop is certainly not an unplanted crop. Carr v. Carr, 208 N.C. 246, 180 S.E. 82 (1935).

Upon the death of a cropper his personal representative is entitled to his share of the crop. Parker v. Brown, 136 N.C. 280, 48 S.E. 657 (1904). See Thomas v. Lines, 83 N.C. 191 (1880).

Applied in James v. James, 58 N.C. App. 292, 293 S.E.2d 655 (1982); Chamberlain v. Beam, 63 N.C. App. 377, 304 S.E.2d 770 (1983).

Cited in Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988); Sisson v. Campbell Univ., Inc., 688 F. Supp. 1064 (E.D.N.C. 1988); Chamblee v. Espy, 100 F.3d 15 (4th Cir. 1996).

§ 28A-15-2. Title and possession of property.

(a) Personal Property. — Subsequent to the death of the decedent and prior to the appointment and qualification of the personal representative or collector, the title and the right of possession of personal property of the decedent is vested in his heirs; but upon the appointment and qualification of the personal representative or collector, the heirs shall be divested of such title and right of possession which shall be vested in the personal representative or collector relating back to the time of the decedent's death for purposes of administering the estate of the decedent. But, if in the opinion of the personal representative, his possession, custody and control of any item of personal property is not necessary for purposes of administration, such possession, custody and control may be left with or surrendered to the heir or devisee presumptively entitled thereto.

(b) Real Property. — The title to real property of a decedent is vested in his heirs as of the time of his death; but the title to real property of a decedent devised under a valid probated will becomes vested in the devisees and shall relate back to the decedent's death, subject to the provisions of G.S. 31-39. (1973, c. 1329, s. 3.)

CASE NOTES

Vesting of Real Property in Heirs. — When a property owner dies intestate, the title to his real property vests immediately in his heirs. The decedent's personal representative has the power, upon petition to the clerk of superior court, to sell decedent's real property for payments of debts and other claims against the decedent's estate, but the proceeding is an adversary one, requiring that the heirs be made parties. If an heir is not joined, the order of sale is void as to him. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

Heirs of wife's deceased husband were necessary parties to equitable distribution action in which husband's administrator had been substituted as defendant, and they were properly added as parties defendant. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

Sale of Land under Discretionary Sale Clause in Will Is Invalid. — Since land is not a part of the estate, a sale by the executors for the reason that it would facilitate the settlement of the special proceeding for partition was not a valid exercise of a power of sale under a will, giving them power to sell such property of the testator as they in their discretion may determine proper. James v. James, 58 N.C. App. 371, 293 S.E.2d 655, cert. denied, 306 N.C. 742, 295 S.E.2d 759 (1982).

Cited in Montgomery v. Hinton, 45 N.C. App. 271, 262 S.E.2d 697 (1980); Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988); State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 538 (2000); State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 614 (2000).

§ 28A-15-3. Nonexoneration of encumbered property.

When real or personal property subject to any lien or security interest, except judgment liens, is specifically devised, the devisee takes the property subject to the encumbrance and without a right to have other assets of the decedent applied to discharge the secured obligation, unless an express provision of the will confers such right of exoneration. A general testamentary direction to pay the debts of the decedent is not sufficient to confer such right. (1973, c. 1329, s. 3.)

Legal Periodicals. — For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

§ 28A-15-4. Encumbered assets.

When any assets of the estate are encumbered by mortgage, pledge, lien or other security interest, the personal representative may pay the encumbrance or any part thereof, renew or extend any obligation secured by the encumbrance, or convey or transfer the encumbered assets to the creditor in satisfaction of his lien, in whole or in part, whether or not the holder of the encumbrance has filed a claim, if it appears to be for the best interest of the estate; provided that payment of an encumbrance shall not increase the share of the distributee entitled to the encumbered assets unless the distributee is entitled to exoneration by express provisions of the will. (1973, c. 1329, s. 3.)

§ 28A-15-5. Order in which assets appropriated; abatement.

(a) General Rules. — In the absence of testamentary indication as to the order of abatement, or some other controlling statute, shares of devisees and of heirs abate, without any preference or priority as between real and personal property, in the following order:

(1) Property not disposed of by the will;
(2) Residuary devises;
(3) General devises;
(4) Specific devises.

For purposes of abatement, a demonstrative devise of money or property payable out of or charged on a particular fund or other property is treated as a specific devise; but if the particular fund or property out of which the demonstrative devise is to be paid is nonexistent or insufficient at the death of the testator, the deficiency is to be payable out of the general estate of the decedent and is to be regarded as a general devise and must abate pro rata with other general devises. Abatement within each classification is in proportion to the amounts of property each of the beneficiaries would have received, had full distribution of the property been made in accordance with the terms of the will.

(b) Abatement; Sales; Contribution. — When property which has been specifically devised is sold, leased, or mortgaged, or a security therein is created, by the personal representative, abatement shall be achieved by ratable adjustments in, or contributions from other interest in the remaining assets. The clerk of superior court shall, at the time of the hearing on the petition for final distribution, determine the amounts of the respective contributions and whether the same shall be made before distribution or shall constitute a lien on specific property which is distributed. (1973, c. 1329, s. 3.)

CASE NOTES

Bequest Not Adeemed by Sale During Testator's Incompetency. — Where the trial court found that testator specifically bequeathed his interest in livestock to his daughter, and subsequently became incompetent and did not regain his competency at any time before his death, and where his interest in livestock was sold by his trustees for $22,543.48, and those funds were included in the assets coming into the hands of the executor, and moreover, where there were sufficient assets in the estate to satisfy all of its obligations as well as all general, specific and demonstrative devises without any abatement of those devises, these findings were sufficient to support the court's conclusion that testator's specific testamentary gift of his interest in livestock to his daughter was not adeemed by the trustee's sale thereof during testator's incompetency before his death. In re Estate of Warren, 81 N.C. App. 634, 344 S.E.2d 795 (1986).

Applied in Chamberlain v. Beam, 63 N.C. App. 377, 304 S.E.2d 770 (1983); Creekmore v. Creekmore, 126 N.C. App. 252, 485 S.E.2d 68 (1997).

Cited in Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979); Creekmore v. Creekmore, 126 N.C. App. 252, 485 S.E.2d 68 (1997).

§ 28A-15-6. Federal income tax refunds — joint returns.

Upon the determination by the United States Treasury Department of an overpayment of income tax by a married couple filing a joint federal income tax return, one of whom has died since the filing of such return or where a joint federal income tax return is filed on behalf of a husband and wife, one of whom has died prior to the filing of the return, any refund of the tax by reason of such overpayment, if not in excess of five hundred dollars ($500.00), shall be the sole and separate property of the surviving spouse. In the event that both spouses are dead at the time such overpayment is determined, such refund, if not in excess of five hundred dollars ($500.00), shall be the sole and separate property of the estate of the spouse who died last and may be paid directly by the Treasury Department to the executor or administrator of such estate, or to the person entitled to the possession of the assets of a small estate pursuant to the provisions of Article 25 of this Chapter. (1955, c. 720; 1957, c. 986; 1973, c. 1329, s. 3.)

CASE NOTES

Applied in Brantley v. Watson, 115 N.C. App. 393, 445 S.E.2d 53 (1994).

§ 28A-15-7. Federal income tax refunds — separate returns.

Upon the determination by the United States Treasury Department of an overpayment of income tax by any married person filing a separate return, any refund of the tax by reason of such overpayment, if not in excess of two hundred fifty dollars ($250.00), exclusive of interest, shall be the sole and separate property of the surviving spouse, and the United States Treasury Department may pay said sum directly to such surviving spouse, and such payment to the extent thereof shall operate as a complete acquittal and discharge of the United States Treasury Department. (1961, c. 643; 1973, c. 1329, s. 3.)

§ 28A-15-8. State income tax returns.

Upon the determination by the Secretary of Revenue of North Carolina of an overpayment of income tax by any married person, any refund of the tax by reason of such overpayment, if not in excess of two hundred dollars ($200.00) exclusive of interest, shall be the sole and separate property of the surviving spouse, and said Secretary of Revenue may pay said sum directly to such surviving spouse, and such payment to the extent thereof shall operate as a complete acquittal and discharge of the Secretary of Revenue. (1961, c. 735; 1973, c. 1329, s. 3.)

CASE NOTES

Deduction of Tax Refunds from Share of Estate Proper. — Order allowing an estate to deduct one-half of the federal income tax refund and a portion of the state income tax refund received by a widow from joint tax returns from the widow's share of the estate was proper. Bryant v. Bowers, — N.C. App. —, 641 S.E.2d 855, 2007 N.C. App. LEXIS 583 (2007).

§ 28A-15-9. Excess funds.

If the amount of any refund exceeds the sums specified in G.S. 28A-15-6, 28A-15-7 or 28A-15-8, the sums specified therein and one half of any additional sums shall be the sole and separate property of the surviving spouse. The remaining one half of such additional sums shall be the property of the estate of the decedent spouse. (1973, c. 1329, s. 3.)

CASE NOTES

Applied in Brantley v. Watson, 115 N.C. App. 393, 445 S.E.2d 53 (1994).

Deduction of Tax Refunds from Share of Estate Proper. — Order allowing an estate to deduct one-half of the federal income tax refund and a portion of the state income tax refund received by a widow from joint tax returns from the widow's share of the estate was proper. Bryant v. Bowers, — N.C. App. —, 641 S.E.2d 855, 2007 N.C. App. LEXIS 583 (2007).

§ 28A-15-9.1. Phase II payments.

A Phase II payment as defined in G.S. 28A-21-3.1 shall be the property of the distributees paid in accordance with that section. (2003-295, s. 1.)

§ 28A-15-10. Assets of decedent's estate for limited purposes.

(a) When needed to satisfy claims against a decedent's estate, assets may be acquired by a personal representative or collector from the following sources:

(1) Tentative trusts created by the decedent in savings accounts for other persons.

(2) Gifts causa mortis made by the decedent.

(3) Joint deposit accounts with right of survivorship created by decedent pursuant to the provisions of G.S. 41-2.1 or otherwise; and joint tenancies with right of survivorship created by decedent in corporate stocks or other investment securities.

(4) An interest in a security passing to a beneficiary pursuant to the provisions of Article 4 of Chapter 41 of the General Statutes.

Such assets shall be acquired solely for the purpose of satisfying such claims, however, and shall not be available for distribution to heirs or devisees.

(b) Where there are not sufficient personal and real assets of the decedent to satisfy all the debts and other claims against his estate, the personal representative shall have the right to sue for and recover any and all personal property or real property, or interest therein, which the decedent may in any manner have transferred or conveyed with intent to hinder, delay, or defraud his creditors, and any personal property or real property, or interest therein, so recovered shall constitute assets of the estate in the hands of the personal representative for the payment of debts and other claims against the estate of the decedent. But if the alienee has sold the personal property or real property, or interest therein, so fraudulently acquired by him from the decedent to a bona fide purchaser for value without notice of the fraud, then such personal property or real property, or interest therein, may not be recovered from such bona fide purchaser but the fraudulent alienee shall be liable to the personal representative for the value of the personal property or real property, or interest therein, so acquired and disposed of to a bona fide purchaser. If the whole recovery from the fraudulent alienee shall not be necessary for the payment of the debts and other claims against the estate of the decedent, the surplus shall be returned to such fraudulent alienee or his assigns.

(c) Where there has been a recovery in an action for wrongful death, the same shall not be applied to the payment of debts and other claims against the estate of decedent or devises, except as to the payment of reasonable burial and funeral expenses and reasonable hospital and medical expenses incident to the injury resulting in death and as limited and provided in G.S. 28-18-2 [G.S. 28A-18-2]. (1973, c. 1329, s. 3; 2005-411, s. 2.)

Cross References. — As to real property recovered from fraudulent alienee being subject to sale, see G.S. 28A-17-5.

CASE NOTES

Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against her based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Cited in In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

§ 28A-15-11. Debt due from personal representative not discharged by appointment.

The appointment of any person as personal representative does not discharge any debt or demand due from such person to the decedent. (1868-9, c. 113, s. 40; Code, s. 1431; Rev., s. 51; C.S., s. 58; 1973, c. 1329, s. 3.)

CASE NOTES

Section Applies to Executor Whether He Acts or Not. — This section applies to an executor who acts as well as to one who does not act under the appointment. Moore v. Miller, 62 N.C. 359 (1868), decided under prior law.

§ 28A-15-12. Examination of persons or corporations believed to have possession of property of decedent.

(a) Whenever a personal representative or collector makes oath or affirmation before the clerk of superior court of the county where the party to be examined resides or does business that he has reasonable ground to believe, setting forth the grounds of his belief, that any person, firm or corporation has in his or its possession any property of any kind belonging to the estate of his decedent, the clerk shall issue a notice to be served upon the person or any member of the firm or officer, agent or employee of the firm or corporation designated in the affidavit, to appear before the clerk at his office at a time fixed in the notice, not less than three days after the issuance of the notice, and be examined under oath by the personal representative or collector or his attorney concerning the possession of such property. If upon examination the clerk of superior court finds that the person examined or the firm or corporation for which he works has in his or its possession any property belonging solely to the decedent, and fails to show any satisfactory reason for retaining possession of the property, the clerk shall issue an order requiring the person, firm or corporation forthwith to deliver the property to said personal representative or collector and may enforce compliance with the order by proceedings as for contempt of court: Provided, that in the case of a firm or corporation, whenever any person other than a partner or executive officer of such firm or corporation is examined, no such order shall be made until at least three days after service of notice upon a partner or executive officer of such firm or corporation to show cause why such order should not be made.

(b) Any person aggrieved by the order of the clerk of superior court may, within five days, appeal to the judge holding the next session of superior court of the county after the order is made or to the resident judge of the district, but as a condition precedent to his appeal he shall give a justified bond in a sum at least double the value of the property in question, conditioned upon the safe delivery of the property and the payment of damages for its detention, to the personal representative or collector in the event that the order of the clerk should be finally sustained. When the bond is executed and delivered to the court, no attachment as for contempt shall be served upon the appealing party and any contempt order theretofore issued shall be stayed; but if the appellant fails to have his appeal heard at the next session of superior court held in his county, or by the resident judge of the district within 30 days after giving notice, the appeal shall be deemed abandoned, and the stay of any contempt order theretofore issued shall terminate.

(c) The party against whom the final judgment is rendered shall be adjudged to pay the costs of the proceedings hereunder.

(d) The remedies provided in this section shall not be exclusive, but shall be in addition to any remedies which are now or may hereafter be provided. (1937, c. 209, s. 1; 1973, c. 1329, s. 3.)

CASE NOTES

This section provides a quick and immediate remedy by which a personal representative may examine any party if he has reasonable grounds to believe a person, firm or corporation has possession of any property belonging to the estate. State v. Jessup, 279 N.C. 108, 181 S.E.2d 594 (1971), decided under prior law.

Such remedy is in addition to other remedies. State v. Jessup, 279 N.C. 108, 181 S.E.2d 594 (1971), decided under prior law.

And it is for the purpose of discovery and recovery without waiting for the slower process of a suit in the superior court. State v. Jessup, 279 N.C. 108, 181 S.E.2d 594 (1971), decided under prior law.

Clerk may force delivery or attach for contempt for failure to deliver. State v. Jessup, 279 N.C. 108, 181 S.E.2d 594 (1971), decided under prior law.

One who takes and refuses to account to the personal representative becomes a trustee for the benefit of the estate and subject to the penalties provided for breach of trust. State v. Jessup, 279 N.C. 108, 181 S.E.2d 594 (1971), decided under prior law.

Attorneys' fees were recoverable by administrators of decedent's estate, as successful parties, in suit by administrators to compel decedent's son to provide an accounting of certain estate property. In re Estate of Katsos, 84 N.C. App. 682, 353 S.E.2d 677, cert. denied, 320 N.C. 169, 358 S.E.2d 52 (1987).

Cited in Sisson v. Campbell Univ., Inc., 688 F. Supp. 1064 (E.D.N.C. 1988).

§ 28A-15-13. Opening and inventory of decedent's safe-deposit box.

(a) Definitions. — The following definitions apply to this section:

(1) Institution. — Any entity or person having supervision or possession of a safe-deposit box to which a decedent had access.

(1a) Deputy. — A person appointed in writing by a lessee or cotenant of a safe-deposit box as having right of access to the safe-deposit box without further authority or permission of the lessee or cotenant, in a manner and form designated by the institution.

(2) Letter of authority. — Letters of administration, letters testamentary, an affidavit of collection of personal property, an order of summary administration, or a letter directed to the institution designating a person entitled to receive the contents of a safe-deposit box to which the decedent had access. The letter of authority must be signed by the clerk of superior court or by the clerk's representative.

(3) Qualified person. — A person possessing a letter of authority or a person named as a deputy, lessee or cotenant of the safe-deposit box to which the decedent had access.

(b) Presence of Clerk Required. — Any safe-deposit box to which a decedent had access shall be sealed by the institution having supervision or possession of the box. Except as provided in subsection (c) of this section, the presence of the clerk of superior court of the county where the safe-deposit box is located or the presence of the clerk's representative is required before the box may be opened. The clerk or the clerk's representative shall open the safe-deposit box in the presence of the person possessing a key to the box and a representative of the institution having supervision or possession of the box. The clerk shall make an inventory of the contents of the box and furnish a copy to the institution and to the person possessing a key to the box.

(c) Presence of Clerk Not Required. — The presence of the clerk of superior court or the clerk's representative is not required when the person requesting the opening of the decedent's safe-deposit box is a qualified person. In that event, the qualified person shall make an inventory of the contents of the box and furnish a copy to the institution and to the person possessing a key to the box if that person is someone other than the qualified person.

(d) Testamentary Instrument in Box. — If the safe-deposit box contains any writing that appears to be a will, codicil, or any other instrument of a testamentary nature, then the clerk of superior court or the qualified person shall file the instrument in the office of the clerk of superior court.

(e) Release of Contents. — Except as provided in subsection (d) for testamentary instruments, the institution shall not release any contents of the safe-deposit box to anyone other than a qualified person.

(f) No Tax Waiver Required. — No tax waiver is required for the release of the contents of the decedent's safe-deposit box. (1998-212, s. 16.14(a); 2003-255, s. 1.)

ARTICLE 16.

Sales or Leases of Personal Property.

§ 28A-16-1. Sales or leases without court order.

(a) A personal representative has the power to sell, at either a public or private sale, or to lease, personal property of the decedent without a court order.

(b) A personal representative who sells or leases personal property of the decedent without a court order is not required to file a special report or have the transaction confirmed by the clerk of superior court, or to follow any of the procedure set forth in Article 29A of Chapter 1 of the General Statutes, entitled "Judicial Sales," but shall include in his next account, either annual or final, a record of the receipts and disbursements incident to the transaction. (1868-9, c. 113, s. 16; Code, s. 1408; Rev., s. 62; C.S., s. 66; 1973, c. 1329, s. 3; 1975, c. 300, s. 6.)

Cross References. — As to incompetency and guardianship, see G.S. 35A-1101 et seq.

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Purchaser Not Responsible for Application of Proceeds. — A purchaser of personalty from a personal representative does not, by virtue of the latter's absolute power to dispose of the personalty, have to see to the proper application of the purchase price. This is so although decedent has created a particular separate fund for the payment of his debts. But if the purchase be tainted with collusion, the purchaser will be held responsible for the proper application of the proceeds. Tyrrell v. Morris, 21 N.C. 559 (1837); Gray v. Armistead, 41 N.C. 74 (1849); Bradshaw v. Simpson, 41 N.C. 243 (1849); Cox v. First Nat'l Bank, 119 N.C. 302, 26 S.E. 22 (1896).

Purchaser gets good title, unless he purchased mala fide and for the purpose of devastavit. Wilson v. Doster, 42 N.C. 231 (1851); Polk v. Robinson, 42 N.C. 235 (1851).

Where he receives the property in payment of the fiduciary's personal debt, the transaction is presumptively mala fide. Latham v. Moore, 59 N.C. 167 (1860).

§ 28A-16-2. Sales or leases by court order.

(a) All sales or leases of personal property of the decedent by a collector shall be made only upon order obtained, by motion, from the clerk of superior court.

(b) A personal representative may, if he so desires, request the clerk of superior court to issue to him an order to sell or lease personal property of the decedent.

(c) Sales or leases of personal property of the decedent held pursuant to court order shall be conducted as provided in Article 29A of Chapter 1 of the General Statutes, entitled "Judicial Sales."

(d) A personal representative may, for his own benefit, purchase or lease personal property belonging to the decedent at a public sale conducted under an order of the clerk of superior court, if the transaction is reported to the clerk of superior court and confirmed by him. (1868-9, c. 113, s. 17; Code, s. 1409; Rev., s. 61; C.S., s. 67; 1949, c. 719, s. 2; 1973, c. 1329, s. 3.)

§ 28A-16-3. Sales of household furnishings.

If the decedent is survived by a spouse, no sale or lease shall be made of the household furnishings in the usual dwelling house occupied by the surviving spouse at the time of the death of the deceased spouse, if such dwelling house was owned by the deceased spouse at the time of his or her death, until the expiration of the time limits set forth in G.S. 29-30(c) for the filing by the surviving spouse of an election in regard to the property of the decedent. (1973, c. 1329, s. 3.)

ARTICLE 17.

Sales, Leases or Mortgages of Real Property.

§ 28A-17-1. Sales of real property.

Pursuant to authority contained in G.S. 28A-15-1 the personal representative may, at any time, apply to the clerk of superior court of the county where the decedent's real property or some part thereof is situated, by petition, to sell such real property for the payment of debts and other claims against the decedent's estate. (1868-9, c. 113, s. 42; Code, s. 1436; Rev., s. 68, C.S., s. 74; 1923, c. 55; 1935, c. 43; 1937, c. 70; 1943, c. 637; 1949, c. 719, s. 2; 1955, c. 302, s. 1; 1959, c. 879, s. 7; 1963, c. 291, s. 1; 1973, c. 1329, s. 3.)

CASE NOTES

I. General Consideration.
II. Practice and Procedure.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Proceeding to sell land under this section is a special proceeding before the clerk, who has original and exclusive jurisdiction of the matter. Baker v. Carter, 127 N.C. 92, 37 S.E. 81 (1900); Holcomb v. Hemric, 56 N.C. App. 688, 289 S.E.2d 620 (1982).

Unless Matter Involves Equities Over Which Superior Court Has Jurisdiction. — If equities are involved in the case upon which the superior court acquires jurisdiction of a part, it will determine the whole matter. Baker v. Carter, 127 N.C. 92, 37 S.E. 81 (1900); Holcomb v. Hemric, 56 N.C. App. 688, 289 S.E.2d 620 (1982).

Bill by United States to Subject Land to Payment of Judgment. — The federal district court had jurisdiction of a bill in equity by the United States to subject to payment of a judgment land situated in this State which had descended to the heirs of the judgment debtor, there being no personal assets. United States v. Minor, 254 F. 57 (4th Cir. 1918).

Presumption of Regularity. — The regularity of the proceedings under this section will be presumed. Wadford v. Davis, 192 N.C. 484, 135 S.E. 353 (1926).

Vesting of Real Property in Heirs. — When a property owner dies intestate, the title to his real property vests immediately in his heirs. The decedent's personal representative has the power, upon petition to the clerk of superior court, to sell decedent's real property for payments of debts and other claims against the decedent's estate, but the proceeding is an adversary one, requiring that the heirs be made parties. If an heir is not joined, the order of sale is void as to him. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

Who May Sell. — The personal representative is the proper party to sell the homestead of deceased for distribution. Tarboro v. Pender, 153 N.C. 427, 69 S.E. 425 (1910).

Nature of Representative's Authority. — The authority of the representative under this section is a naked power without title or interest in the estate. He is a mere agent of the court. Floyd v. Herring, 64 N.C. 409 (1870).

Representative Could Be Compelled to Sell under Former Statute. — See Pelletier v. Saunders, 67 N.C. 261 (1872); Wilson v. Bynum, 92 N.C. 717 (1885); Clement v. Cozart, 109 N.C. 173, 13 S.E. 862 (1891); Lee v. McKoy, 118 N.C. 518, 24 S.E. 210 (1896); Yarborough v. Moore, 151 N.C. 116, 65 S.E. 763 (1909); Hobbs v. Cashwell, 152 N.C. 183, 67 S.E. 495 (1910); Flynn v. Rumley, 212 N.C. 25, 192 S.E. 868 (1937).

Amount of Realty Which May Be Sold. — This section authorizing the sale of the lands of a decedent is in derogation of the common law, and hence the courts will not deny to an administrator the discretion of selling less land than is ordered to be sold, if necessity should not arise for such sale; and, conversely, the administrator will be allowed to continue to sell lands embraced in the license so long as the necessity to raise assets exists. Sledge v. Elliott, 116 N.C. 712, 21 S.E. 797 (1895).

"At Any Time." — The phrase "at any time," which appeared in the first sentence of a former statute, presupposed an application without undue delay. Pelletier v. Saunders, 67 N.C. 261 (1872); Clement v. Cozart, 109 N.C. 173, 13 S.E. 862 (1891); Creech v. Wilder, 212 N.C. 162, 193 S.E. 281 (1937).

If personalty has been wasted by the representative, his successor must first resort to his bond before proceeding against the lands. Lilly v. Wooley, 94 N.C. 412 (1886); Clement v. Cozart, 107 N.C. 695, 12 S.E. 254 (1890).

But this does not apply where representative is insolvent, his bond lost, and sureties unknown. Brittain v. Dickson, 104 N.C. 547, 10 S.E. 701 (1889).

Lands Not Assets Until Sold. — Lands are not assets for the payment of the debts until they are sold and the proceeds received by the administrator. Wilson v. Bynum, 92 N.C. 717 (1885).

The heirs should be given the opportunity to resist and prevent the land from being applied to the payment of a debt which they allege was wrongfully obtained. Holcomb v. Hemric, 56 N.C. App. 688, 289 S.E.2d 620 (1982).

Claimant of Sole Seizin May Have Claim Adjudicated and Pay Debts to Prevent Sale. — While under this section an administrator is entitled to sell lands of the deceased to make assets to pay debts of the estate, when a person claims sole seizin under a contract to devise as against the heirs of intestate, such person is entitled to adjudication of her claim of sole seizin before a sale of the property to make assets is ordered, since she may elect to discharge the debts of the estate and the costs of administration to prevent a sale of the lands. Chambers v. Byers, 214 N.C. 373, 199 S.E. 398 (1938).

Creditor Attacking Debt as Fraudulent. — A judgment creditor of a devisee desiring to attack a debt set forth in the petition to sell land as being fraudulent must do so in the same proceedings, and not by independent action. Wadford v. Davis, 192 N.C. 484, 135 S.E. 353 (1926).

Homestead of a minor child of a testator cannot be sold during the minority of such child. Bruton v. McRea, 125 N.C. 206, 34 S.E. 397 (1899). See Hinsdale v. Williams, 75 N.C. 430 (1876).

Child who was made a party must have claimed homestead rights, otherwise he cannot subsequently claim as against the purchaser of the land. Dickens v. Long, 112 N.C. 311, 17 S.E. 150 (1893).

Allotment of Dower in Lands in Another County Invalid. — Deceased died seized of lands lying in two counties, and an administrator, appointed in the county of his residence, instituted proceedings in the other county to sell lands to make assets. The widow appeared therein asking that the lands be sold subject to dower and averring that she would later institute proceedings for the allotment of dower. Upon order of the clerk that the widow's dower be allotted and that the remaining lands be sold to make assets, a sheriff and jury from that county went into the county of deceased's residence and allotted dower by metes and bounds. It was held that the allotment was invalid, that the clerk of the other county was without authority to enter the order for the allotment of dower notwithstanding he had jurisdiction of the proceedings to sell lands to make assets, and might have ordered the lands sold subject to dower, and that the only provisions of this section giving the clerk jurisdiction in regard to dower in lands outside his county was where the widow consents that the lands be sold clear of dower and that a certain part of the proceeds of sale be set apart to her in commutation of dower. High v. Pearce, 220 N.C. 266, 17 S.E.2d 108 (1941).

Converting into Creditor's Suit. — When proceedings for the sale of land are instituted under this section by the representative, they cannot be converted into a creditor's suit. Brittain v. Dickson, 111 N.C. 529, 16 S.E. 326 (1892).

Effect of Judgment Quando. — See Wilson v. Bynum, 92 N.C. 717 (1885).

Cited in Montgomery v. Hinton, 45 N.C. App. 271, 262 S.E.2d 697 (1980); State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 538 (2000).

II. PRACTICE AND PROCEDURE.

Proper Parties. — In proceedings to sell land, heirs and devisees are necessary parties. Person v. Montgomery, 120 N.C. 111, 26 S.E. 645 (1897).

Sale Though Parties Not in Esse. — The application for sale may be made notwithstanding the existence of devises to parties not in esse. Carraway v. Lassiter, 139 N.C. 145, 51 S.E. 968 (1905).

Heirs of wife's deceased husband were necessary parties to equitable distribution action in which husband's administrator had been substituted as defendant, and they were properly added as parties defendant. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

Notice to Creditors Unnecessary. — No notice to creditors is required to be given under this section. Thompson v. Cox, 53 N.C. 311 (1860).

Venue. — The proper venue to make the application provided by this section is in the county where the land or some part thereof is situated. Ellis v. Adderton, 88 N.C. 472 (1883).

It is in the county where the land or some part thereof lies, and not in the county where the decedent was domiciled and administration granted, that the application for sale must be filed, though formerly it could be filed in the county last referred to. Ellis v. Adderton, 88 N.C. 472 (1883).

Removal to Proper County. — A petition filed in the wrong county may, upon application, be removed to the proper county. See Falls of Neuse Mfg. Co. v. Brower, 105 N.C. 440, 11 S.E. 313 (1890).

Statute of Limitations Does Not Bar Right or Duty to Sell Realty. — As long as the estate remained unsettled, and real property of the decedent remained subject to sale, the administrator could unquestionably proceed by proper petition in the original proceeding to have the real property sold for the payment of outstanding debts and for the final settlement of the estate. No statute of limitations barred that right or the performance of that duty. Rocky Mount Sav. & Trust Co. v. McDearman, 213 N.C. 141, 195 S.E. 531 (1938).

As long as the estate remains unsettled, no statute of limitations bars the right and duty of the personal representative to sell lands to make assets to pay the debts of the estate. Gibbs v. Smith, 218 N.C. 382, 11 S.E.2d 140 (1940).

But a representative cannot sell land to pay debts barred. Robinson v. McDowell, 133 N.C. 182, 45 S.E. 545 (1903).

And heirs or devisees may plead statute of limitations or any other defense to an application for license to sell for payment of debts on which no judgment is obtained. Bevers v. Park, 88 N.C. 456 (1883); Syme v. Riddle, 88 N.C. 463 (1883); Speer v. James, 94 N.C. 417 (1886); Proctor v. Proctor, 105 N.C. 222, 10 S.E. 1036 (1890); Person v. Montgomery, 120 N.C. 111, 26 S.E. 645 (1897).

Unless Judgment Has Been Obtained. — If a judgment has been previously obtained for the debt the heirs or devisees are concluded thereby (except where fraud and collusion can be shown) and they cannot now plead any defense which could have been, but was not, pleaded by the representative. Long v. Oxford, 108 N.C. 280, 13 S.E. 112 (1891). See also Smith v. Brown, 101 N.C. 347, 7 S.E. 890 (1888); Brittain v. Dickson, 104 N.C. 547, 10 S.E. 701 (1889); Proctor v. Proctor, 105 N.C. 222, 10 S.E. 1036 (1890); Lassiter v. Upchurch, 107 N.C. 411, 12 S.E. 63 (1890); Woodlief v. Bragg, 108 N.C. 571, 13 S.E. 211 (1891). But see Tilley v. Bivins, 112 N.C. 348, 16 S.E. 759 (1893); Person v. Montgomery, 120 N.C. 111, 26 S.E. 645 (1897).

§ 28A-17-2. Contents of petition for sale.

The petition to sell real property shall include:

(1) A description of the real property and interest therein sought to be sold;

(2) The names, ages and addresses, if known, of the devisees and heirs of the decedent;

(3) A statement that the personal representative has determined that it is in the best interest of the administration of the estate to sell the real property sought to be sold. (1868-9, c. 113, s. 43; Code, s. 1437; Rev., s. 77; C.S., s. 79; 1973, c. 1329, s. 3.)

§ 28A-17-3. Petition for partition.

When it is alleged that the real property of the decedent sought to be sold consists in whole or in part of an undivided interest in real property, the personal representative of the decedent may include, in the petition to sell the real property for the payment of debts and other claims against the decedent's estate, a request for partition of the lands sought to be sold. (1868-9, c. 113, s. 42; Code, s. 1436; Rev., s. 68; C.S., s. 74; 1923, c. 55; 1935, s. 43; 1937, c. 70; 1943, c. 637; 1949, c. 719, s. 2; 1955, c. 302, s. 1; 1959, c. 879, s. 7; 1963, c. 291, s. 1; 1973, c. 1329, s. 3.)

§ 28A-17-4. Heirs and devisees necessary parties.

No order to sell real property shall be granted until the heirs and devisees of the decedent have been made parties to the proceeding by service of summons in the manner required by law. Upon such service, the court shall appoint a guardian ad litem for heirs and devisees who are unknown or whose addresses are unknown, and summons shall issue to him as such. The guardian ad litem shall file answer for such heirs and devisees and defend for them, and he shall be paid such sum as the court may fix, to be paid as costs of the proceeding. (1868-9, c. 113, s. 44; Code, s. 1438; Rev., s. 74; C.S., s. 80; Ex. Sess. 1924, c. 3, s. 1; 1973, c. 1329, s. 3; 1975, c. 300, s. 7.)

Cross References. — As to parties, see G.S. 1A-1, Rule 17.

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Vesting of Real Property in Heirs. — When a property owner dies intestate, the title to his real property vests immediately in his heirs. The decedent's personal representative has the power, upon petition to the clerk of superior court, to sell decedent's real property for payments of debts and other claims against the decedent's estate, but the proceeding is an adversary one, requiring that the heirs be made parties. If an heir is not joined, the order of sale is void as to him. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

Heirs at law of intestate are necessary parties to an action by an administrator to subject an interest in lands of his intestate to the payment of debts of the estate. In re Daniel's Estate, 225 N.C. 18, 33 S.E.2d 126 (1945).

Section Applies to Infants. — This section applies to making heirs and devisees parties, whether infants or adults. Perry v. Adams, 98 N.C. 167, 3 S.E. 729 (1887); Harrison v. Harrison, 106 N.C. 282, 11 S.E. 356 (1890).

Heir Not Made Party May Attack Decree. — An heir who was not made a party, or served, may subsequently assail the validity of the decree and proceed against the purchaser. Dickens v. Long, 109 N.C. 165, 13 S.E. 841 (1891). See also Webb v. Atkinson, 122 N.C. 683, 29 S.E. 949 (1898).

As to Such Heir, Decree Is Void. — As to an heir not made a party or served, whether he be an adult or an infant, the decree is absolutely void, not merely voidable, and can be collaterally attacked. Nor would the fact that he had knowledge of the sale and took no steps to prevent it cure the lack of service. Harrison v. Harrison, 106 N.C. 282, 11 S.E. 356 (1890); Card v. Finch, 142 N.C. 140, 54 S.E. 1009 (1906).

Heirs of wife's deceased husband were necessary parties to equitable distribution action in which husband's administrator had been substituted as defendant, and they were properly added as parties defendant. Swindell v. Lewis, 82 N.C. App. 423, 346 S.E.2d 237 (1986).

§ 28A-17-5. Property subject to sale; conveyance by deceased in fraud of creditors.

The real property subject to sale under this Article shall include real property recovered from a fraudulent alienee pursuant to G.S. 28A-15-10(b). (1868-9, c. 113, s. 51; Code, s. 1446; Rev., s. 72; C.S., s. 77; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Salable Interest. — Every interest in real estate, whether legal or equitable, is subject to sale. Waugh v. Blevins, 68 N.C. 167 (1873); Mannix v. Ihrie, 76 N.C. 299 (1877).

Only Debtor's Interest Is Subject to Sale. — Under this section only the interest of the deceased debtor in land which he may have conveyed in fraud of creditors is subject to sale. Heck v. Williams, 79 N.C. 437 (1878); Egerton v. Jones, 107 N.C. 284, 12 S.E. 434 (1890).

Conveyance Must Be by Deceased. — Where A, being in embarrassed circumstances, purchased land from B, and caused B to convey to his (A's) son, it was held that the land could not be sold for the payment of A's debts. Rhem v. Tull, 35 N.C. 57 (1851).

Conveyance Must Be in Fraud of Creditors. — Under this section lands conveyed cannot be sold unless it can be shown that they were conveyed in fraud of creditors. McCaskill v. Graham, 121 N.C. 190, 28 S.E. 264 (1897).

Innocent Purchasers Protected. — Under this section an administrator cannot be compelled to sell property fraudulently conveyed but in the hands of an innocent purchaser. Harrington v. Hatton, 129 N.C. 146, 39 S.E. 780 (1901).

Conveyance to Wife and Children. — Property conveyed by the decedent to his wife and children without consideration in fraud of his creditors while insolvent may be recovered and sold by the administrator on behalf of the creditors. Webb v. Atkinson, 122 N.C. 683, 29 S.E. 949 (1898); Webb v. Atkinson, 124 N.C. 447, 32 S.E. 737 (1899).

Fraudulent Grantee's Rights as Creditor. — Where the wife is the fraudulent grantee and the creditor of her husband, in proceedings to set aside the conveyance to her, she is entitled to her pro rata claim out of the proceeds of the land the same as the other creditors are. Nadal v. Britton, 112 N.C. 180, 16 S.E. 915 (1893).

Burden of proof that the conveyance was fair and for a full consideration was upon the grantees, where the decedent, while insolvent, had conveyed real property to his wife and children. Webb v. Atkinson, 122 N.C. 683, 29 S.E. 949 (1898).

§ 28A-17-6. Adverse claimant to be heard; procedure.

When the real property sought to be sold, or any interest therein, is claimed by another person, such claimant may be made a party to the proceeding, and in any event may become a party upon his own motion. When an issue of law or fact is joined between the parties, the procedure shall be as prescribed for other special proceedings. (1868-9, c. 113, ss. 46, 47; Code, ss. 1440, 1441; Rev., ss. 76, 78; C.S., ss. 81, 82; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Right to Be Heard as Party. — Any person who claims to be the owner of the land has the right to be made a party and to have an inquiry made as to his title. Gibson v. Pitts, 69 N.C. 155 (1873).

Where land is claimed by another, such claimant may be admitted to be heard as a party to a proceeding to sell lands of intestate to make assets to pay debts, or may be brought in as a party thereto. In re Daniel's Estate, 225 N.C. 18, 33 S.E.2d 126 (1945).

Claims of Undivided Interest. — One who claims an undivided interest in lands sought to be sold to pay debts, may be properly made a party to the proceedings. McKeel v. Holloman, 163 N.C. 132, 79 S.E. 445 (1913).

Failure to Determine Issue of Title. — Where the order of sale is granted without determining an issue of title raised under this section, the order is void, and the title of the purchaser with notice of such issue is voidable. Perry v. Peterson, 98 N.C. 63, 3 S.E. 834 (1887).

Issue of Law Submitted to Judge. — Where a demurrer is filed to the petition filed before the clerk, the issue of law thereby raised must, under this section, be certified to the judge at chambers. Then the judge must transmit his decision thereon to the clerk; it is error for him to direct an order of sale after overruling the demurrer. Jones v. Hemphill, 77 N.C. 42 (1887).

Procedure. — The rulings or decisions of the clerk must be transferred for trial to the next succeeding term of the superior court, if determinative issues arise on the pleadings; and if there be issues of law or material questions of fact decided by the clerk, they may be reviewed by the judge at term or in chambers on appeal properly taken. In passing upon these questions of fact, the court may act on the evidence already received, or may require the production of other evidence. Mills v. McDaniel, 161 N.C. 112, 76 S.E. 551 (1912).

§ 28A-17-7. Order granted if petition not denied; public or private sale; procedure for sale.

If, by default or admission, the allegations in the petition are not controverted, the clerk of superior court may summarily order a sale. The procedure for the sale shall be as is provided in Article 29A of Chapter 1 of the General Statutes, entitled "Judicial Sales." If it is made to appear to the clerk by petition and by satisfactory proof that it will be for the best interest of the estate to sell by private sale, the clerk may authorize a private sale in accordance with the provisions of G.S. 1-339.33 through 1-339.40. (1868-9, c. 113, s. 48; Code, s. 1443; Rev., s. 79; C.S., s. 83; 1949, c. 719, s. 2; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Powers of Clerk. — The clerk of the superior court, for the purpose of decreeing a sale in case provided by this section, represents and is the court, and has authority to exercise the discretionary powers conferred. Tillett v. Aydlett, 90 N.C. 551 (1884).

Unsigned Decree of Sale. — It is not essential to the validity of the decree that it should be signed. Sledge v. Elliott, 116 N.C. 712, 21 S.E. 797 (1895).

Decree Not Conclusive of Debts. — The decree of the sale is not conclusive of the debts recited by the personal representative in his application for the sale of the land. Latta v. Russ, 53 N.C. 111 (1860).

§ 28A-17-8. Under power in will, sales public or private.

Sales of real property made pursuant to authority given by will may be either public or private, unless the will otherwise directs, and may be on such terms as in the opinion of the personal representative are most advantageous to those interested in the decedent's estate. (1868-9, c. 113, s. 75; Code, s. 1503; Rev., s. 84; C.S., s. 89; 1973, c. 1329, s. 3.)

§ 28A-17-9. Death of vendor under contract; representative to convey.

When any decedent has contracted to sell any real property and has given bond or other enforceable written contract to the purchaser to convey the same, his personal representative may execute and deliver a deed to such real property and such deed shall convey the title as fully as if it had been executed and delivered by the decedent. No deed shall be made unless the purchaser complies with the terms of the bond or other written contract. If the contract for conveyance requires the giving of a warranty deed, the deed given by the personal representative shall contain such warranties as required by the contract and the warranties shall be binding on the estate and not on the personal representative personally. (1868-9, c. 113, s. 65; 1874-5, c. 251; Code, s. 1492; Rev., s. 83; C.S., s. 91; 1973, c. 1329, s. 3.)

Legal Periodicals. — For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Remedy of Optionee Where Option Not Exercised Before Landowner's Death. — This section contemplates only contracts of conveyance of a bilateral nature. Hence where the owner of the land dies before the option given by him is exercised the representative has, under this section, no power to convey; and the optionee's remedy is against the heirs or the devisees. Mizell v. Dennis Simmons Lumber Co., 174 N.C. 68, 93 S.E. 436 (1917).

Section Not Applicable to Restore Lost Deeds. — This section does not apply to cases where a deed is executed in performance of the condition of the bond to convey, but is lost after the death of the vendor and before its registration. Hodges v. Hodges, 22 N.C. 72 (1838).

Registration and Payment Prerequisites. — Unless the contract for the sale is proved and registered and the purchase money is paid in full (now terms of bond or other written contract complied with), a deed made by the representative is inoperative. Taylor v. Hargrove, 101 N.C. 145, 7 S.E. 647 (1888).

Showing of Consideration. — The person claiming under the contract must show that there was a valuable consideration thereof, and such other circumstances as would be equivalent to a payment of that consideration. Lindsay v. Coble, 37 N.C. 602 (1843).

Deed executed by representative before contract for sale had been proven and registered, and the purchase money paid in full, was inoperative. Taylor v. Hargrove, 101 N.C. 145, 7 S.E. 647 (1888).

Warranty of Title. — This section empowers the representative to convey only such interest as the vendor could sell. Hence where the vendor contracts to sell his interest in the land, the representative cannot be expected to warrant the title of the land. Twitty v. Lovelace, 97 N.C. 54, 2 S.E. 661 (1887).

Equitable Defense Against Bond. — Where the representative in compliance with this section executes the deed to the purchaser, any equitable defense against the bond may be set up against such deed. McCraw v. Gwin, 42 N.C. 55 (1850).

Judgment Against Administrator Ineffectual Against Heir. — Under N.C. Const., Art. I, § 19, a judgment cannot bind a person unless he comes or is brought before the court in some way sanctioned by law and afforded an opportunity to be heard in defense of his rights. As an inexorable consequence of this constitutional provision, any judgment which may be rendered in an action against a decedent's administrator will be wholly ineffectual as against an heir of the decedent, who is not a party to such action, even though such action is predicated upon this section. Scott v. Jordan, 235 N.C. 244, 69 S.E.2d 557 (1952).

Heirs as Necessary Parties to Suit by Representative. — In an action brought by the personal representative of an obligor in a bond for title to subject the land to the payment of the purchase money, the heirs of the obligor are necessary parties. But if the bond is proved and registered and the section has been complied with, in proceedings for the sale of such land, the presence of the heirs is perhaps not necessary. Grubb v. Lookabill, 100 N.C. 267, 6 S.E. 390 (1888).

§ 28A-17-10. Title in personal representative for estate; he or successor to convey.

When real property is conveyed to a personal representative for the benefit of the estate he represents, he or any successor personal representative may sell and convey it upon such terms as he may deem just and for the advantage of the estate. The procedure shall be as is provided in Article 29A of Chapter 1 of the General Statutes, entitled "Judicial Sales." If it is made to appear to the clerk of superior court by petition and by satisfactory proof that it will be for the best interest of the estate to sell by private sale, the clerk may authorize a private sale in accordance with the provisions of G.S. 1-339.33 through 1-339.40. (1905, c. 342; Rev., s. 71; C.S., s. 92; 1949, c. 719, s. 2; 1973, c. 1329, s. 3.)

§ 28A-17-11. Personal representative may lease or mortgage.

In lieu of asking for an order of sale of real property, the personal representative may request the clerk of superior court to issue to him an order to lease or to mortgage real property of the decedent. The clerk of superior court is authorized to issue an order to lease or mortgage on such terms as he deems to be in the best interest of the estate. (1913, c. 49, s. 1; C.S., s.75; 1927, c. 222, s. 1; 1973, c. 1329, s. 3.)

CASE NOTES

Subrogation of Representative Who Personally Pays Debts. — Where an administrator, in good faith pending the mortgaging of property of the estate to pay debts, personally pays the debts of the estate, he is entitled to be subrogated to the rights of the creditors whose debts he had paid, and upon the execution of the mortgage, upon order of court, is entitled to repay himself from the proceeds of the loan. Caffey v. Osborne, 210 N.C. 252, 186 S.E. 364 (1936), decided under prior law.

Cited in State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 538 (2000).

§ 28A-17-12. Sale, lease or mortgage of real property by heirs or devisees.

(a) If the first publication or posting of the general notice to creditors as provided for in G.S. 28A-14-1 occurs within two years after the death of the decedent:

(1) All sales, leases or mortgages of real property by heirs or devisees of any resident or nonresident decedent made after the death of the decedent and before the first publication or posting of the general notice to creditors are void as to creditors and personal representatives; and

(2) All sales, leases or mortgages of real property by heirs or devisees of any resident or nonresident decedent made after such first publication or posting and before approval of the final account shall be void as to creditors and personal representatives unless the personal representative joins in the sale, lease or mortgage.

(b) If the first publication or posting of the general notice to creditors as provided for in G.S. 28A-14-1 does not occur within two years after the death of the decedent, all sales, leases or mortgages of real property by heirs or devisees of any resident or nonresident decedent shall be valid as to creditors and personal representatives of the decedent. (1973, c. 1329, s. 3; 1979, 2nd Sess., c. 1246, s. 1.)

§ 28A-17-13. Prior validating acts.

Chapter 70 of the Public Laws of 1923, Chapter 48 of the Public Laws of 1925, Chapter 146 of the Public Laws of 1931, and Chapters 31 and 381 of the Public Laws of 1935, all validating certain prior sales of real property by executors or administrators and heretofore codified as G.S. 28-100 through 28-104, shall remain in full force and effect, though no longer carried forward as part of the General Statutes. (1973, c. 1329, s. 3.)

Article 18.

Actions and Proceedings.

§ 28A-18-1. Survival of actions to and against personal representative.

(a) Upon the death of any person, all demands whatsoever, and rights to prosecute or defend any action or special proceeding, existing in favor of or against such person, except as provided in subsection (b) hereof, shall survive to and against the personal representative or collector of his estate.

(b) The following rights of action in favor of a decedent do not survive:

(1) Causes of action for libel and for slander, except slander of title;

(2) Causes of action for false imprisonment;

(3) Causes of action where the relief sought could not be enjoyed, or granting it would be nugatory after death. (1868-9, c. 113, ss. 63, 64; Code, ss. 1490, 1491; Rev., ss. 156, 157; 1915, c. 38; C.S., ss. 159, 162; 1965, c. 631; 1973, c. 1329, s. 3.)

Cross References. — As to abatement of actions, see G.S. 1A-1, Rule 25.

Legal Periodicals. — For note on libel by will, see 33 N.C.L. Rev. 146 (1954).

For note on survival of actions for alienation of affections and criminal conversation, see 35 N.C.L. Rev. 428 (1957).

For article on recent developments in North Carolina tort law, see 48 N.C.L. Rev. 791 (1970).

For note, "Vendor Liability for the Sale of

Alcohol to an Underage Person: The Untoward Consequences of Estate of Mullis v. Monroe Oil Co.," see 21 Campbell L. Rev. 277 (1999).

CASE NOTES

I. General Consideration.
II. Revival and Survival of Actions.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Section Changes Common Law. — The rule of the common law that a personal right of action dies with the person has been changed by this section and former G.S. 1-74 (see now G.S. 1A-1, Rule 25), and, except in the instances specified in subsection (b), an action originally maintainable by or against a deceased person is now maintainable by or against his personal representative. Suskin v. Maryland Trust Co., 214 N.C. 347, 199 S.E. 276 (1938). See Mast v. Sapp, 140 N.C. 533, 53 S.E. 350 (1906).

The rule of the common law that a personal right of action dies with the person has been changed by former G.S. 1-74 (see now G.S. 1A-1, Rule 25) and this section. Paschal v. Autry, 256 N.C. 166, 123 S.E.2d 569 (1962).

This section clearly manifests a two-fold legislative purpose: (1) To declare what causes of action survive the death of the person in whose favor or against whom they have accrued; and (2) to designate the persons who may sue or be sued upon such surviving causes of action. McIntyre v. Josey, 239 N.C. 109, 79 S.E.2d 202 (1953); Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 323 N.C. 171, 373 S.E.2d 104 (1988).

Availability of Survivorship Action. — Trial court properly granted summary judgment to defendant as to an insurance company's action under the survivorship statute, G.S. 28A-18-1, because the claim was based on a single negligent act of defendant, and thus the sole remedy available was under the wrongful death statute, G.S. 28A-18-2, and any wrongful death action was barred by the statute of limitations under G.S. 1-53(4). State Auto Ins. Co. v. Blind, — N.C. App. —, 650 S.E.2d 25, 2007 N.C. App. LEXIS 1940 (2007).

Limitation for Wrongful Death Action Based on Medical Malpractice Not Extended by § 1-15(c). — Section 1-15(c) would not apply to extend statute of limitations for plaintiff bringing action for wrongful death based on alleged acts of medical malpractice; plaintiff was required to bring her wrongful death claim within two years of deceased's death, pursuant to G.S. 1-53(4). King v. Cape Fear Mem. Hosp., 96 N.C. App. 338, 385 S.E.2d 812, cert. denied, 326 N.C. 265, 389 S.E.2d 114 (1990).

A viable fetus is a "person" under the Wrongful Death Act and the estate of such a person may bring an action for damages. Greer v. Parsons, 103 N.C. App. 463, 405 S.E.2d 921, aff'd, 331 N.C. 368, 416 S.E.2d 174 (1992).

Decedent's personal representative is the proper party plaintiff in a wrongful death action. Brendle v. General Tire & Rubber Co., 408 F.2d 116 (4th Cir. 1969).

Substitution Order Ineffective As To Personal Representative Not Yet Appointed. — Where order directing the substitution of a yet-to-be-appointed personal representative for deceased defendant did not comply with G.S. 28A-18-1 or G.S. 1A-1, Rule 25, the order could not operate retroactively to substitute him as defendant once the personal representative was appointed, and the trial court erred in granting plaintiffs' summary judgment motion because the personal representative did not receive timely notice of the motion under G.S. 1A-1, Rule 56. Dixon v. Hill, 174 N.C. App. 252, 620 S.E.2d 715, 2005 N.C. App. LEXIS 2393 (2005), cert. denied, — U.S. —, 126 S. Ct. 2972, 165 L. Ed. 2d 954 (2006).

Action by the personal representative of deceased stillborn child was not barred by the release executed by child's parents, as the release by its terms bound only themselves and their heirs and assigns as to their personal claims and did not purport to settle or affect a claim for the child's wrongful death, and since under North Carolina law the parents, though the child's next of kin, had no authority to either assert or settle a claim for the child's wrongful death; only the child's personal representative had that authority. Greer v. Parsons, 103 N.C. App. 463, 405 S.E.2d 921, aff'd, 331 N.C. 368, 416 S.E.2d 174 (1992).

Debt Due Decedent Can Be Collected Only by Administrator. — If a debt is due a decedent, it can be collected only by his administrator. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Since pending the administration of an estate title to personal property of an intestate vests in his administrator and not his heirs, it necessarily follows that the administrator, and not creditors or heirs, is the proper party to bring an action to collect a debt due the estate or to recover specific personal property. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Exceptions to Rule That Administrator Bring Suit. — To the general rule that the administrator must bring suit there are certain exceptions. If the administrator has refused to bring the action to collect the assets; if there is collusion between a debtor and a personal representative — particularly if the latter is insolvent; or, if some other peculiar circumstance warrants it, the creditors or heirs may bring the action which the personal representative should have brought. However, in such a case the administrator must be a party defendant. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Collector of the estate of a deceased tort-feasor can be sued in his representative capacity upon a cause of action under this section. McIntyre v. Josey, 239 N.C. 109, 79 S.E.2d 202 (1953).

Right to Retain Attorney. — Until a personal representative is appointed for an estate, no one has the right to retain an attorney to represent the estate. In re Alston, 10 N.C. App. 46, 177 S.E.2d 745 (1970), appeal dismissed, 277 N.C. 725, 178 S.E.2d 830 (1971).

Removal of Personal Representative for Failure to Prosecute or Defend Action. — In a proper case, a personal representative may be removed for failure to prosecute or defend actions in behalf of the estate he represents, but clearly a request to sue and a refusal would be conditions precedent. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Suit by Heir to Collect His Share of Decedent's Funds in Hands of Third Party. — A suit by one of the heirs to collect his share of decedent's funds in the hands of a third person is no different from a suit by a creditor of the estate to collect a debt due it. In the absence of allegations bringing the suit within one of the exceptions, this has never been permitted. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Without alleging that the administrator has refused to bring suit or that there was collusion, one of six heirs of an intestate, by making his administrator a party defendant, may not maintain an action against another of the heirs for his distributive share of decedent's money which that other is wrongfully withholding. Spivey v. Godfrey, 258 N.C. 676, 129 S.E.2d 253 (1963).

Breach of a condition subsequent contained in a deed entitles the grantor during his life, or his heirs after his death, to bring suit for the land or to declare the estate forfeited, but does not entitle the administrator to bring such suit, this section not being applicable. Barkley v. Thomas, 220 N.C. 341, 17 S.E.2d 482 (1941).

Bank Deposit Vests in Personal Representative. — Where a bank was obligated in an unstated amount to its depositor, when he died, the relationship theretofore subsisting was that of debtor and creditor, and the title to said account vested in the depositor's personal representative for collection and administration. Monroe v. Dietenhoffer, 264 N.C. 538, 142 S.E.2d 135 (1965).

Action Properly Dismissed Against Defendants Who Were Merely Collectors by Affidavit. — Where plaintiff was required by this statute to bring his action against the collector or personal representative, his action was properly dismissed when he filed his action against defendants who were merely collectors by affidavit under G.S. 28A-25-1, since plaintiff failed to bring his action against the proper party or parties. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 323 N.C. 171, 373 S.E.2d 104 (1988).

Summary Judgment for Deceased Defendant Ineffective Where Motion to Substitute Personal Representative Had Never Been Ruled Upon. — After defendant doctor died, the medical malpractice action survived only against the personal representative or collector of the estate pursuant to G.S. 28A-18-1(a), and thus where the trial court never ruled upon the motion under G.S. 1A-1, Rule 25(a) to substitute the executrix of the estate the trial court's summary judgment order with respect to the doctor had no effect. Purvis v. Moses H. Cone Mem'l Hosp. Serv. Corp., 175 N.C. App. 474, 624 S.E.2d 380, 2006 N.C. App. LEXIS 128 (2006).

Exclusivity of Workers' Compensation Remedies. — Even if a forklift driver was not trained to sound a horn when entering or exiting defendant employer's plant, there was no evidence injury or death was substantially certain to occur as the forklift had been operated in a similar manner for a number of years with no similar accident; a wrongful death action filed by a deceased worker's representative under the North Carolina Wrongful Death Act, G.S. 28A-18-1 through G.S. 28A-18-8, was precluded by G.S. 97-9, G.S. 97-10.1, of the North Carolina Workers' Compensation Act, G.S. 97-1 et seq., and summary judgment was therefore granted to the employer. Southern v. Metromont Materials, L.L.C., 331 F. Supp. 2d 386, 2004 U.S. Dist. LEXIS 6958 (W.D.N.C. 2004).

Jury Issue Raised. — Personal representative's wrongful death and survivorship claims could be brought in the same suit and separate issues should have been presented to the jury on whether a nursing home's negligence caused the decedent's pre-death injuries and wrongful death; the nursing home's claim that a personal representative was required to delineate which of the decedent's pressure sores caused his death and which sores caused him pain and suffering prior to his death was rejected as if the jury determined that the decedent died of Alzheimer's disease, rather than an infection from the pressure sores, it could still reasonably determine that the nursing home's negligence caused the pressure sores and that any or all of those sores caused the decedent pain and suffering prior to his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Alternative Claims for Wrongful Death and Survivorship. — Wrongful death and survivorship claims may be brought as alternative claims for the same negligent acts. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Applied in Mazzocone v. Drummond, 42 N.C. App. 493, 256 S.E.2d 843 (1979); Keener v. Korn, 46 N.C. App. 214, 264 S.E.2d 829 (1980); Tinkham v. Hall, 47 N.C. App. 651, 267 S.E.2d 588 (1980); Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843 (1982); Elmore v. Elmore, 67 N.C. App. 661, 313 S.E.2d 904 (1984); McGowen v. Rental Tool Co., 109 N.C. App. 688, 428 S.E.2d 275 (1993); Sweet v. Boggs, 134 N.C. App. 173, 516 S.E.2d 888 (1999); Estate of Fennell v. Stephenson, 37 N.C. App. 430, 528 S.E.2d 911, 2000 N.C. App. LEXIS 428 (2000).

Cited in Carnahan v. Reed, 53 N.C. App. 589, 281 S.E.2d 408 (1981); Strong v. Johnson, 53 N.C. App. 54, 280 S.E.2d 37 (1981); Day v. Coffey, 68 N.C. App. 509, 315 S.E.2d 96 (1984); Waller v. Butkovich, 584 F. Supp. 909 (M.D.N.C. 1984); Clark v. Inn W., 324 N.C. 415, 379 S.E.2d 23 (1989); Turner v. Duke Univ., 325 N.C. 152, 381 S.E.2d 706 (1989); Caldwell v. Caldwell, 103 N.C. App. 380, 405 S.E.2d 588 (1991); Greer v. Parsons, 331 N.C. 368, 416 S.E.2d 174 (1992); McInnis v. Provident Life & Accident Ins. Co., 21 F.3d 586 (4th Cir. 1994); Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994); Jones v. Rochelle, 125 N.C. App. 82, 479 S.E.2d 231 (1996); Estate of Mullis v. Monroe Oil Co., 349 N.C. 196, 505 S.E.2d 131 (1998); Farm Bureau Ins. Co. of N.C., Inc. v. Blong, 159 N.C. App. 365, 583 S.E.2d 307, 2003 N.C. App. LEXIS 1497 (2003), cert. denied, 357 N.C. 578, 589 S.E.2d 125 (2003); Champion v. PPG Indus., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 9034 (W.D.N.C. Apr. 2, 2004).

II. REVIVAL AND SURVIVAL OF ACTIONS.

All Causes of Action Survive Except Those Specified in Subsection (b). — It appears that under this section all causes of action survive the death of the person in whose favor or against whom they have accrued, except the causes of action specified in subsection (b). McIntyre v. Josey, 239 N.C. 109, 79 S.E.2d 202 (1953).

Causes of Action Specified in Subsection (b). — Sister's petition to declare her brother incompetent was nugatory after the death of the brother and did not survive the death of the brother; thus, the appeal abated and became moot upon the brother's death and was dismissed. In re Higgins, 160 N.C. App. 704, 587 S.E.2d 77, 2003 N.C. App. LEXIS 1908 (2003).

Civil Action Based Upon Personal Injuries. — This section provides that a civil action based upon personal injuries survives the death of the plaintiff. Schronce v. Coniglio, 124 N.C. App. 216, 476 S.E.2d 366 (1996).

Cause of action which survives against successor personal representatives of an estate likewise survives in favor of successor personal representatives of the estate. Harrison v. Carter, 226 N.C. 36, 36 S.E.2d 700 (1946).

Revival and Survival of Action against Representative. — The general rule is that wherever an action can be revived against the representative, it will also survive against him. Butner v. Keelhn, 51 N.C. 60 (1858).

Action Not Time Barred. — Action filed on October 20, 2000, two days after qualification of deceased driver's personal representative, for personal injuries arising out of an automobile accident that occurred on June 27, 1997, was not barred by G.S. 1-52, where deceased died on November 7, 1997, at which time the three year limitations period had not yet expired, as under G.S. 28A-18-1 plaintiff's cause of action survived his death, and thus, pursuant to G.S. 1-22, plaintiff was permitted to commence a cause of action against deceased's personal representative, provided that either the action was brought within the time specified for the presentation of claims in G.S. 28A-19-3, or that notice of the claim upon which the action was based was presented to the personal representative within the time specified for the presentation of claims in G.S. 28A-19-3. The personal representative's failure to establish in the record that she complied with G.S. 28A-19-3(a) regarding general notice to creditors precluded her from relying upon the statute of limitations as a bar; moreover, under G.S. 28A-14-1(a), the absolute earliest "deadline" date which could have been specified by the personal representative in the general notice to creditors was January 18, 2001, three months from the day of the first publication or posting of such notice. Mabry v. Huneycutt, 149 N.C. App. 630, 562 S.E.2d 292, 2002 N.C. App. LEXIS 271 (2002).

This section does not revive the action against a distributee, but against the personal representative. Healey v. R.J. Reynolds Tobacco Co., 48 F. Supp. 207 (M.D.N.C. 1942).

Action for Divorce Did Not Survive Husband's Death. — Trial court did not err in dismissing husband's action for divorce and wife's counterclaim for equitable distribution where husband died before decree of absolute divorce was granted. Caldwell v. Caldwell, 93

N.C. App. 740, 379 S.E.2d 271, cert. denied, 325 N.C. 270, 384 S.E.2d 513 (1989).

A divorce judgment which has not been shown to be void may not be set aside following the death of one of the parties so as to reinstate the marital relationship; while a divorce decree which affects property rights of the parties may on timely motion be amended, altered, or modified, the trial court does not have the jurisdiction to change the adjudged marital status of the parties. Dunevant v. Dunevant, 142 N.C. App. 169, 542 S.E.2d 242, 2001 N.C. App. LEXIS 47 (2001).

Annulment Action Survived Decedent's Death. — Where an executrix had filed a case on a decedent's behalf as his guardian ad litem, seeking an annulment of the decedent's marriage while the decedent was alive, and where substantial property rights hinged on the validity of the marriage, the action did not abate on the decedent's death and the executrix was entitled to pursue it. Clark v. Foust-Graham, 171 N.C. App. 707, 615 S.E.2d 398, 2005 N.C. App. LEXIS 1365 (2005).

Cause of Action for Tortious Injury to Personal Property. — Since it is not one of the causes of action enumerated in subsection (b), a cause of action for a tortious injury to personal property survives the death of either party. McIntyre v. Josey, 239 N.C. 109, 79 S.E.2d 202 (1953).

Action for Negligent Injury. — The fact that the injury in suit did not cause the death of the injured party, but that death resulted from another cause, does not prevent the survival of an action for negligent injury. Fuquay v. A. & W. Ry., 199 N.C. 499, 155 S.E. 167 (1930).

Personal representative was entitled to proceed on both a survivorship claim and a wrongful death claim where he alleged that a nursing home's negligence resulted not only in the decedent's death, but also in injury, pain and suffering, and medical expenses prior to his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Trial court should have submitted survivorship issues to the jury as a personal representative presented sufficient evidence of the decedent's pre-death injuries, including evidence related to the questions of preventability of the decedent's pressure sores, the treatment of those wounds, and whether and to what degree the wounds caused the decedent pain; the personal representative presented substantial evidence, notwithstanding the nursing home's contrary evidence, to allow the jury to conclude that the nursing home negligently failed to prevent the decedent's pressure sores and that those pressure sores caused the decedent pain and suffering prior to his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Action Under Tort Claims Act. — Recovery against the county board of education pursuant to the North Carolina Tort Claims Act did not bar plaintiff's claims against the individual bus driver who caused the wreck, or plaintiff's uninsured motorist/underinsured motorist (UM/UIM) carrier for damages in excess of the maximum recovery allowable under the Tort Claims Act. Oakley v. Thomas, 112 N.C. App. 130, 434 S.E.2d 663 (1993).

There is a surviving cause of action for predeath expenses and pain and suffering. Brendle v. General Tire & Rubber Co., 408 F.2d 116 (4th Cir. 1969).

An injured person's common-law right of action to recover damages for hospital and medical expenses and for pain and suffering caused by the negligence of another survives to the injured party's personal representative. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Right of a ward to sue his guardian for lack of diligence in the care of the estate survives to the ward's administrator. Kuykendall v. Proctor, 270 N.C. 510, 155 S.E.2d 293 (1967).

An action brought by the administrator of a ward's estate against the guardian to recover money lost because of lack of diligence by the guardian is not one for relief which could not be enjoyed, or the granting of which would be nugatory after death, so as to fall within the class specified in subdivision (3) of subsection (b). Kuykendall v. Proctor, 270 N.C. 510, 155 S.E.2d 293 (1967).

Action for Wrongful Cutting and Removal of Timber. — If a cause of action for damages for the wrongful cutting and removal of timber from realty belonging to the deceased, in whole or in part, accrued during his lifetime, the action for damages survives to his executors, and must be brought by his executors rather than by his heirs or devisees. However, if such an injury to the realty was committed after his death, the right of action belongs to his heirs or devisees. Paschal v. Autry, 256 N.C. 166, 123 S.E.2d 569 (1962).

Vindictive Damages. — Though the cause of action for trespass may survive against the representative of the trespasser, no vindictive damages may be recovered in such action. Rippey v. Miller, 33 N.C. 247 (1850).

Survivorship Claim Sufficiently Pled. — Personal representative sufficiently pled a survivorship claim for a decedent's pre-death injuries where he made allegations primarily directed to the injuries sustained by, and damages caused to, the decedent in counts separate from a count in which he requested the damages listed in G.S. 28A-18-2 and several of the damages pled were not damages recoverable under G.S. 28A-18-2; because the damages were not lumped together, they did not appear to relate to a single claim, but related to separate claims for damages sustained by the decedent due to the nursing home's negligent actions during his lifetime and the negligence allegedly causing his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

§ 28A-18-2. Death by wrongful act of another; recovery not assets.

(a) When the death of a person is caused by a wrongful act, neglect or default of another, such as would, if the injured person had lived, have entitled him to an action for damages therefor, the person or corporation that would have been so liable, and his or their personal representatives or collectors, shall be liable to an action for damages, to be brought by the personal representative or collector of the decedent; and this notwithstanding the death, and although the wrongful act, neglect or default, causing the death, amounts in law to a felony. The personal representative or collector of the decedent who pursues an action under this section may pay from the assets of the estate the reasonable and necessary expenses, not including attorneys' fees, incurred in pursuing the action. At the termination of the action, any amount recovered shall be applied first to the reimbursement of the estate for the expenses incurred in pursuing the action, then to the payment of attorneys' fees, and shall then be distributed as provided in this section. The amount recovered in such action is not liable to be applied as assets, in the payment of debts or legacies, except as to burial expenses of the deceased, and reasonable hospital and medical expenses not exceeding four thousand five hundred dollars ($4,500) incident to the injury resulting in death, except that the amount applied for hospital and medical expenses shall not exceed fifty percent (50%) of the amount of damages recovered after deducting attorneys' fees, but shall be disposed of as provided in the Intestate Succession Act. The limitations on recovery for hospital and medical expenses under this subsection do not apply to subrogation rights exercised pursuant to G.S. 135-40.13A. All claims filed for such services shall be approved by the clerk of the superior court and any party adversely affected by any decision of said clerk as to said claim may appeal to the superior court in term time.

(b) Damages recoverable for death by wrongful act include:

(1) Expenses for care, treatment and hospitalization incident to the injury resulting in death;

(2) Compensation for pain and suffering of the decedent;

(3) The reasonable funeral expenses of the decedent;

(4) The present monetary value of the decedent to the persons entitled to receive the damages recovered, including but not limited to compensation for the loss of the reasonably expected;

  a. Net income of the decedent,

  b. Services, protection, care and assistance of the decedent, whether voluntary or obligatory, to the persons entitled to the damages recovered,

  c. Society, companionship, comfort, guidance, kindly offices and advice of the decedent to the persons entitled to the damages recovered;

(5) Such punitive damages as the decedent could have recovered pursuant to Chapter 1D of the General Statutes had he survived, and punitive damages for wrongfully causing the death of the decedent through malice or willful or wanton conduct, as defined in G.S. 1D-5;

(6) Nominal damages when the jury so finds.

(c) All evidence which reasonably tends to establish any of the elements of damages included in subsection (b), or otherwise reasonably tends to establish the present monetary value of the decedent to the persons entitled to receive the damages recovered, is admissible in an action for damages for death by wrongful act.

(d) In all actions brought under this section the dying declarations of the deceased shall be admissible as provided for in G.S. 8-51.1. (R.C., c. 1, s. 10; c. 46, ss. 8, 9; 1868-9, c. 113, ss. 70-72, 115; Code, ss. 1498-1500; Rev., ss. 59, 60; 1919, c. 29; C.S., ss. 160, 161; 1933, c. 113; 1951, c. 246, s. 1; 1959, c. 879, s. 9; c. 1136; 1969, c. 215; 1973, c. 464, s. 2; c. 1329, s. 3; 1981, c. 468; 1985, c. 625; 1993, c. 299, s. 1; 1995, c. 514, s. 2; 1997-456, s. 7; 2006-264, s. 66(b).)

Cross References. — As to admissibility of dying declarations in civil and criminal proceedings, see G.S. 8-51.1 and G.S. 8C-1, Rule 804. As to power of personal representative to maintain action for wrongful death and to compromise or settle any such claims, subject to approval of judge of superior court, see G.S. 28A-13-3(23).

Effect of Amendments. — Session Laws 2006-264, s. 66(b), effective August 27, 2006, and applicable to payments made by the Plan after July 20, 2004, for which reimbursement is sought on or after August 27, 2006, and also applicable to wrongful deaths occurring on or after August 27, 2006, inserted the next-to-last sentence of subsection (a).

Legal Periodicals. — For discussion of the right of husband or wife to recover damages for the loss of consortium by reason of injury or death, see 3 N.C.L. Rev. 98 (1925).

For critical appraisal of former wrongful death statute, see 11 N.C.L. Rev. 263 (1933); 16 N.C.L. Rev. 211 (1938).

As to admissibility of evidence relating to damages recoverable for wrongful death, see 28 N.C.L. Rev. 106 (1950).

For note on possibility of recovery for wrongful death of unborn child, see 28 N.C.L. Rev. 245 (1950).

As to necessity prior to the 1951 amendment of former wrongful death statute for alleging that action for wrongful death was instituted within one year, see 28 N.C.L. Rev. 334 (1950).

For note on action for death based upon breach of warranty of fitness in sale of drug, see 30 N.C.L. Rev. 478 (1952).

For comment on wrongful death damages in North Carolina, see 44 N.C.L. Rev. 402 (1966).

For case law survey as to damages, see 44 N.C.L. Rev. 993 (1966).

For note on parent-child tort immunity, see 44 N.C.L. Rev. 1169 (1966).

For comment on Stetson v. Easterling, 274 N.C. 152, see 47 N.C.L. Rev. 280 (1968).

For comment on Greene v. Nichols, 274 N.C. 18, see 47 N.C.L. Rev. 281 (1968).

For note on wife's right to husband's consortium, see 47 N.C.L. Rev. 1006 (1969).

For note on choice of law rules in North Carolina, see 48 N.C.L. Rev. 243 (1970).

For comment on new North Carolina wrongful death statute, see 48 N.C.L. Rev. 594 (1970).

For article on recent developments in North Carolina tort law, see 48 N.C.L. Rev. 791 (1970).

For article on the 1969 amendments to the former wrongful death statute, see 6 Wake Forest Intra. L. Rev. 211 (1970).

For survey of 1976 case law on torts, see 55 N.C.L. Rev. 1088 (1977).

For note on the interaction between North Carolina's wrongful death statute and its statute of limitations for not readily apparent personal injuries or product defects, see 13 Wake Forest L. Rev. 543 (1977).

For survey of 1977 law on torts, see 56 N.C.L. Rev. 1136 (1978).

For survey of 1979 tort law, see 58 N.C.L. Rev. 1561 (1980).

For article, "North Carolina's New Products Liability Act: A Critical Analysis," see 16 Wake Forest L. Rev. 171 (1980).

For survey of 1980 law on civil procedure, see 59 N.C.L. Rev. 1053 (1981).

For survey of 1980 tort law, see 59 N.C.L. Rev. 1239 (1981).

For survey of 1982 law on torts, see 61 N.C.L. Rev. 1225 (1983).

For article, "Legal Implications of Human in Vitro Fertilization for the Practicing Physician in North Carolina," see 6 Campbell L. Rev. 5 (1984).

For article, "Economic Valuation for Wrongful Death," see 6 Campbell L. Rev. 47 (1984).

For note on use of the family purpose doctrine when no outsiders are involved, in light of Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984), see 21 Wake Forest L. Rev. 243 (1985).

For comment, "Wrong Without a Remedy—North Carolina and the Wrongful Death of a Stillborn," see 9 Campbell L. Rev. 93 (1986).

For note discussing the appointment of an administrator for a decedent's estate to create diversity of citizenship, see 21 Wake Forest L. Rev. 489 (1986).

For note discussing wrongful death recovery for a viable unborn fetus, in light of DiDonato v. Wortman, 80 N.C. App. 117, 341 S.E.2d 58 (1986), see 16 N.C. Cent. L.J. 207 (1987).

For note on the wrongful death of a viable fetus in North Carolina, see 66 N.C.L. Rev. 1291 (1988).

For note on the expansion of the viable fetus wrongful death action, see 11 Campbell L. Rev. 91 (1988).

For note on the wrongful death of a viable fetus, see 23 Wake Forest L. Rev. 849 (1988).

For note, "Examining DiDonato Damage Limitation and Mandatory Joinder Requirements — Greer v. Parsons," see 15 Campbell L. Rev. 97 (1992).

For article, "Person or Thing — In Search of the Legal Status of a Fetus: A Survey of North Carolina Law," see 17 Campbell L. Rev. 169 (1995).

For comment, "In re Estate of Lunsford and Statutory Ambiguity: Trying to Reconcile Child Abandonment and the Intestate Succession Act," 81 N.C.L. Rev. 1149 (2003).

CASE NOTES

I. General Consideration.
II. Limitation of the Action.
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V. Damages Recoverable.
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VI. Admission of Dying Declarations.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto. In addition, most of the cases below were decided prior to the 1993 amendment, which raised to $4,500 the limit on the amount recovered in a wrongful death action that is liable for the payment of hospital and medical expenses of the decedent.*

Constitutionality. — Subdivision (b)(4) is not unconstitutionally vague and therefore violative of N.C. Const., Art. I, § 19. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

History of Subsection (b). — See Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Purpose of Section. — The purpose of this section was to withdraw claims of this kind from the effect and operation of the maxim actio personalis moritur cum persona, and to continue, as the basis of the claim of his estate, the wrongful injury to the person resulting in death. Mitchell v. Talley, 182 N.C. 683, 109 S.E. 882 (1921).

Section Creates New Cause of Action. — The cause of action for personal injuries ceases with the death of the injured party and the action under this section is not a survival of the former but an entirely new action. Harper v. Commissioners of Nash County, 123 N.C. 118, 31 S.E. 384 (1898); Bolick v. Southern R.R., 138 N.C. 370, 50 S.E. 689 (1905). See Taylor v. Cranberry Iron & Coal Co., 94 N.C. 525 (1886).

This section creates a new cause of action only in the sense that at common law the right did not survive to the personal representative. Mitchell v. Talley, 182 N.C. 683, 109 S.E. 882 (1921).

The wrongful death statute confers a new right of action with damages limited to fair and just compensation for the pecuniary injury resulting from death, recoverable by the personal representative for the benefit of the heirs. Hoke v. Atlantic Greyhound Corp., 226 N.C. 332, 38 S.E.2d 105 (1946). See McCoy v. Atlantic C.L.R.R., 229 N.C. 57, 47 S.E.2d 532 (1948).

The wrongful death statute confers a new right of action which did not exist before the statute and which at the death of an injured person accrued to the personal representative of the decedent for the benefit of a specific class of beneficiaries. Crawford v. Hudson, 3 N.C. App. 555, 165 S.E.2d 557 (1969), overruled on other grounds, Gibson v. Campbell, 28 N.C. App. 653, 222 S.E.2d 449 (1976).

No Such Right Existed at Common Law. — The right of recovery for death by wrongful act did not exist at common law, and rests entirely upon this section. Broadnax v. Broadnax, 160 N.C. 432, 76 S.E. 216 (1912); Hinnant v. Tidewater Power Co., 189 N.C. 120, 126 S.E. 307 (1925), overruled on other grounds, 300 N.C. 300, 266 S.E.2d 821 (1980); Wilson v. Massagee, 224 N.C. 705, 32 S.E.2d 335 (1944); Webb v. Eggleston, 228 N.C. 574, 46 S.E.2d 700 (1948); Lewis v. North Carolina State Hwy. & Pub. Works Comm'n, 228 N.C. 618, 46 S.E.2d 705 (1948); Bryant v. Atlantic C.L.R.R., 248 N.C. 43, 102 S.E.2d 393 (1958); Horney v. Meredith Swimming Pool Co., 267 N.C. 521, 148 S.E.2d 554 (1966); Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972); Skinner v. Whitley, 281 N.C. 476, 189 S.E.2d 230 (1972);

Christenbury v. Hedrick, 32 N.C. App. 708, 234 S.E.2d 3 (1977).

No right of recovery for death by wrongful act existed at common law. Colyar v. Atlantic States Motor Lines, 231 N.C. 318, 56 S.E.2d 647 (1949).

The right to maintain an action for wrongful death is purely statutory. No such right existed at common law, and the provisions of this section authorizing the institution and maintenance of such an action are no more binding upon the courts than the provisions of this section which direct how the recovery in such action shall be distributed. Davenport v. Patrick, 227 N.C. 686, 44 S.E.2d 203 (1947).

Such Right Is Purely Statutory. — The right of action for wrongful death is purely statutory. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963); Young v. Marshburn, 10 N.C. App. 729, 180 S.E.2d 43, cert. denied, 278 N.C. 703, 181 S.E.2d 603 (1971); Burcl v. North Carolina Baptist Hosp., 47 N.C. App. 127, 266 S.E.2d 726 (1980), rev'd on other grounds, 306 N.C. 214, 293 S.E.2d 85 (1982); Nelson v. United States, 541 F. Supp. 816 (M.D.N.C. 1982).

In North Carolina the action for wrongful death exists only by virtue of this section. In re Ives' Estate, 248 N.C. 176, 102 S.E.2d 807 (1958); Gay v. Thompson, 266 N.C. 394, 146 S.E.2d 425 (1966).

In North Carolina a right of action to recover damages for wrongful death is given by this section and in this jurisdiction the action for wrongful death exists only by virtue of these statutes. In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

Actions for wrongful death are creatures of statute. Reeves v. Hill, 272 N.C. 352, 158 S.E.2d 529 (1968).

The right of action for wrongful death exists only by virtue of this section, which defines the right of action, and the basis on which damages may be recovered. Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968).

A wrongful death action is a creature of statute and may be brought only as the authorizing statutes permit. Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Because the right to an action for wrongful death rests entirely upon this section, the Wrongful Death Act, it must be asserted in conformity therewith. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

Construction. — This section is not penal but remedial in its nature, and it should be given such construction as will effectuate the intention of the legislature in enacting it. Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905); Hall v. Southern R.R., 149 N.C. 108, 62 S.E. 899 (1908); Christenbury v. Hedrick, 32 N.C. App. 708, 234 S.E.2d 3 (1977).

Preemption. — Where decedent was killed in automobile accident, Employee Retirement Income Security Act (ERISA) preempted the operation of North Carolina's wrongful death statute to the extent that the state law precluded operation of the terms of the "Acts of Third Parties" clause in the plan requiring reimbursement to plan. McInnis v. Provident Life & Accident Ins. Co., 21 F.3d 586 (4th Cir. 1994).

No Simultaneous Constitutional Recovery. — The trial court properly dismissed the plaintiffs' constitutional claim against defendant/police officer pursuant to G.S. 1A-1-12(b)(6) where the plaintiffs had an adequate remedy at law, a wrongful death claim under this section which would compensate plaintiffs for the same alleged injuries. Estate of Fennell v. Stephenson, 37 N.C. App. 430, 528 S.E.2d 911, 2000 N.C. App. LEXIS 428 (2000).

Application of Section to Actions Pursuant to 42 U.S.C. § 1983. — There is no federal statutory law governing the measure of damages in wrongful death actions brought pursuant to 42 USC G.S. 1983, and, therefore, 42 USC G.S. 1988 compels the use of the law of North Carolina: namely, this section. Bowling v. Oldham, 753 F. Supp. 588 (M.D.N.C. 1990).

The North Carolina wrongful death statute satisfies the two underlying policies of 42 U.S.C. § 1983, as it provides adequate relief for the estate of the deceased, and satisfies the policy of preventing abuses of power by state officials by the availability of punitive damages. Bowling v. Oldham, 753 F. Supp. 588 (M.D.N.C. 1990).

"Person" in former § 28-173 construed to mean one who has become recognized as a person by being born alive. See Cardwell v. Welch, 25 N.C. App. 390, 213 S.E.2d 382, cert. denied, 287 N.C. 464, 215 S.E.2d 623 (1975); Yow v. Nance, 29 N.C. App. 419, 224 S.E.2d 292, cert. denied, 290 N.C. 312, 225 S.E.2d 833 (1976). But see DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987), allowing recovery for the wrongful death of a viable but unborn child.

For case calling for legislative action under former § 28-173 if it was intended that wrongful death statute include unborn fetuses, see Cardwell v. Welch, 25 N.C. App. 390, 213 S.E.2d 382, cert. denied, 287 N.C. 464, 215 S.E.2d 623 (1975); Yow v. Nance, 29 N.C. App. 419, 224 S.E.2d 292, cert. denied, 290 N.C. 312, 225 S.E.2d 833 (1976). But see DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987), allowing recovery for the wrongful death of a viable but unborn child.

Municipalities Not Exempt from Section. — The plain, positive provisions of this section contain no basis for supposing that the Legislature intended to exempt municipalities therefrom. Jackson v. Housing Auth., 73 N.C. App. 363, 326 S.E.2d 295 (1985), aff'd, 316 N.C. 259, 341 S.E.2d 523 (1986).

This section does not regard the family relation, and is not for the purpose of compensating the families of persons killed by accident. Russell v. Windsor Steamboat Co., 126 N.C. 961, 36 S.E. 191 (1900).

Right of Action a Property Right. — This section gives clear indication of the purpose of the legislature to impress upon the right of action the character of property as a part of the intestate's estate. Neill v. Wilson, 146 N.C. 242, 59 S.E. 674 (1907); In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

This section contemplates only one cause of action, and when the action is brought by the personal representative, the judgment is conclusive on other persons, and the right given by the statute is exhausted. Kendrick v. Cain, 272 N.C. 719, 159 S.E.2d 33 (1968).

Section Encompasses Loss of Consortium Claims. — The trial court properly dismissed plaintiff's claim brought in her individual capacity for loss of consortium based on the ground that the wrongful death statute encompasses loss of consortium claims, and any common law claim encompassed by the wrongful death statute should have been asserted under this section by the personal representative for the deceased. Keys v. Duke Univ., 112 N.C. App. 518, 435 S.E.2d 820 (1993).

The tort claim for "loss of consortium", no matter what damages may be recovered thereunder, is covered under the wrongful death statute, and plaintiff could not, therefore, bring an independent claim for loss of consortium in her action asserting a claim for wrongful death. Keys v. Duke Univ., 112 N.C. App. 518, 435 S.E.2d 820 (1993).

There is no separate cause of action in the parent to recover for loss of services of a minor child whose death occurs simultaneously with its injury. Gibson v. Campbell, 28 N.C. App. 653, 222 S.E.2d 449 (1976).

Suit by Parent in Individual Capacity for Expenses of Deceased Child Properly Dismissed. — Any common-law claim which is now encompassed by this section must be asserted under it, and accordingly it is proper to dismiss an action by the surviving mother of unemancipated minor children who died as a result of an automobile collision, in which action the mother sought recovery in her individual capacity of, inter alia, medical and funeral expenses incurred on behalf of the children. Boulton v. Onslow County Bd. of Educ., 58 N.C. App. 807, 295 S.E.2d 246 (1982).

Such Expenses Recoverable in Wrongful Death Suit. — Under common law a personal injury to minor child, proximately caused by negligence of another, gave rise to two distinct causes of action: one by the child for damages for the personal injury, and a second by the parent for, inter alia, expenses incurred for necessary medical treatment of the child. However, when the General Assembly legislates in respect to the subject matter of any common-law rule, the statute supplants the common law and becomes the public policy of this State. The General Assembly has provided that damages recoverable for death by wrongful act include, inter alia, expenses for care, treatment and hospitalization incident to the injury resulting in death and the reasonable funeral expenses of the decedent. Boulton v. Onslow County Bd. of Educ., 58 N.C. App. 807, 295 S.E.2d 246 (1982).

Where Deceased Is an Infant. — Under this section the administrator may sue for the death of an infant a few months old. Russell v. Windsor Steamboat Co., 126 N.C. 961, 36 S.E. 191 (1900); Davis v. Seaboard Air Line R.R., 136 N.C. 115, 48 S.E. 591 (1904).

What Constitutes a Cause of Action. — It is entirely immaterial for the purpose of establishing a cause of action under the provisions of this section whether the act was wanton or cruel. Facts showing a legal duty and neglect thereof on the part of defendant with a resulting injury to the plaintiff are sufficient to constitute a cause of action. Western Union Tel. Co. v. Catlett, 177 F. 71 (4th Cir. 1910).

No Action Available. — Where a police officer's actions in shooting and killing the decedent as he approached the officer while brandishing a knife were reasonable as a matter of law, they could not be negligent or wrongful as required to support an action under this section. Sigman v. Town of Chapel Hill, 161 F.3d 782 (4th Cir. 1998).

Plaintiff must show failure of defendant to exercise proper care in performance of some legal duty which the defendant owed plaintiff's testator under the circumstances in which they were placed, and that such negligent breach of duty was the proximate cause of injury which produced death — a cause that produced the result in continuous sequence, and without which it would not have occurred, and one from which any man of ordinary prudence could have foreseen that such result was probable under the existing facts. Tysinger v. Coble Dairy Prods., 225 N.C. 717, 36 S.E.2d 246 (1945); Rogers v. Green, 252 N.C. 214, 113 S.E.2d 364 (1960); Harris v. Wright, 268 N.C. 654, 151 S.E.2d 563 (1966).

Negligence Per Se. — Trial court did not err in admitting testimony that decedent did not have motorcycle endorsement at time of accident. Violation of G.S. 20-7 is negligence per se. Ward v. McDonald, 100 N.C. App. 359, 396 S.E.2d 337 (1990).

Negligence Alone Does Not Create

Cause of Action. — Negligence alone, without pecuniary injury resulting from such death, does not create a cause of action. Gay v. Thompson, 266 N.C. 394, 146 S.E.2d 425 (1966); Harris v. Wright, 268 N.C. 654, 151 S.E.2d 563 (1966); Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968); Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Gross negligence is "something less than willful and wanton conduct," and includes "the absence of even slight care," "indifference to the rights and welfare of others," "negligence of an aggravated character." Cowan v. Brian Ctr. Mgt. Corp., 109 N.C. App. 443, 428 S.E.2d 263 (1993).

Child Not a "Trespasser." — Child who was electrocuted when he entered power company's cabinet containing high voltage wires located on property on which the company had an easement, who had permission of the landowners to play on the property, was not a trespasser as that term has been defined by our case law, and thus the power company was not entitled to have its legal duty reduced. Cole v. Duke Power Co., 81 N.C. App. 213, 344 S.E.2d 130, cert. denied, 318 N.C. 281, 347 S.E.2d 462 (1986).

Joinder of Action for Wrongful Death of Viable Fetus. — The action for wrongful death of a viable fetus must be joined with any action based on the same facts brought by the decedent's parents. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987), reversing DiDonato v. Wortman, 80 N.C. App. 117, 341 S.E.2d 58 (1986).

Lack of Administrator for Fetus's Estate Not Grounds for Dismissal Where Clerk Unwilling to Issue Letters of Administration. — Cause of action for the wrongful death of the fetus was not subject to dismissal on grounds that it was not brought by the personal representative of the deceased as required by subsection (a), where the failure to bring this action in the name of the administrator of the estate was apparently due to the unwillingness of the clerk of court to issue letters of administration for a fetus's "estate." The existence of a cause of action for wrongful death is sufficient for the appointment of an administrator, and since a wrongful death action exists for a viable fetus, the clerk should have appointed an administrator to bring the action. Ledford v. Martin, 87 N.C. App. 279, 359 S.E.2d 505 (1987), cert. denied, 321 N.C. 473, 365 S.E.2d 1 (1988), overruled on other grounds, Johnson v. Ruark Obstetrics, 327 N.C. 283, 395 S.E.2d 85 (1990).

The right of action for wrongful death is limited to such as would, if the injured party had lived, have entitled him to an action for damages therefor. Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968).

In determining whether any wrongful death action is maintainable, the Supreme Court has consistently analyzed the question in terms of whether the deceased, had he lived, would have had a claim against defendant for the injuries inflicted. If so, then the estate of the deceased may maintain an action for wrongful death; if not, then the action for wrongful death will not lie. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

The wrongful death action exists if and only if the decedent could have maintained an action for negligence or some other misconduct if the decedent had survived. Nelson v. United States, 541 F. Supp. 816 (M.D.N.C. 1982).

This section makes it a condition precedent to a right of action in a personal representative that the death of the intestate was caused by a wrongful act, neglect or default of the manufacturer "such as would, if the injured person had lived, have entitled him to an action for damages therefor." Raftery v. Wm. C. Vick Constr. Co., 291 N.C. 180, 230 S.E.2d 405 (1976).

The condition precedent, "such as would, if the injured person had lived, have entitled him to an action for damages therefor," to the maintenance of an action under this section does not, by its express terms, include a time limitation but, upon its face, relates to the nature of the "wrongful act, neglect or default" which caused the death and to the legal capacity of the decedent to sue therefor had he lived. Raftery v. Wm. C. Vick Constr. Co., 291 N.C. 180, 230 S.E.2d 405 (1976).

Theory of Liability Is Same as for Tortious Infliction of Personal Injury. — Although a wrongful death action may be a distinct cause of action from one for negligent infliction of personal injury, the theory or theories of liability and the operative facts from which liability arises are not different. Nelson v. United States, 541 F. Supp. 816 (M.D.N.C. 1982).

Apart from the measure of damages, recovery for wrongful death in North Carolina depends upon the same proof of actionable negligence or misconduct under the general rules of tort liability which would apply to an action strictly for personal injury. Nelson v. United States, 541 F. Supp. 816 (M.D.N.C. 1982).

No Action Where Decedent Fully Compensated before Death. — Where the injured party has received in his lifetime full compensation for the injury which resulted in his death, a right of action arising from the same injury will not lie after his death for further damages for the benefit of his estate. Edwards v. Interstate Chem. Co., 170 N.C. 551, 87 S.E. 635 (1916).

Killing in Georgia of North Carolina Resident. — The wrongful death statute of Georgia is not so dissimilar from this section in scope, meaning, and practical application as to deprive the trial courts of this State of jurisdiction to hear and determine a cause for the negligent killing in the state of Georgia of a resident of this State. Rodwell v. Camel City Coach Co., 205 N.C. 292, 171 S.E. 100 (1933).

Right Must Be Asserted in Conformity with Section. — The right to maintain an action for damages for wrongful death must be asserted in conformity with this section. Webb v. Eggleston, 228 N.C. 574, 46 S.E.2d 700 (1948); Lewis v. Farm Bureau Mut. Auto. Ins. Co., 243 N.C. 55, 89 S.E.2d 788 (1955).

Pleading Requirements. — While a request for damages based on a decedent's pain and suffering and hospital care could have been construed as invoking an action for survival, the plaintiff only intended to go forward with a wrongful death claim if the complaint stated a claim for wrongful death of the decedent and pled all the damages listed in G.S. 28A-18-2(b), with the exception of nominal damages, and there was no indication in the complaint that the damages were to be distributed to his estate as opposed to his heirs. Locust v. Pitt County Mem'l Hosp., 154 N.C. App. 103, 571 S.E.2d 668, 2002 N.C. App. LEXIS 1410 (2002), cert. denied, 356 N.C. 673, 579 S.E.2d 272 (2003).

Where decedent's daughter repeatedly requested that wrongful death action be brought, and offered to pay all expenses for it, but was confronted with alleged collusion and willful obstruction on the part of administratrix and attorney, and within the two-year statute of limitations period, filed action against administratrix, attorney and insurer alleging breach of fiduciary duties and collusion, her contributory negligence, if any, in failing to seek removal of administratrix, was not such as to warrant dismissal under G.S. 1A-1, Rule 12(b)(6). Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984).

Failure to List Possible Wrongful Death Action as Estate Asset Held Malpractice. — Attorney who was retained by decedent's administratrix (sister of decedent's husband) owed a duty to decedent's natural daughter to use reasonable care in representing the estate, and daughter's allegation that he violated that duty by failing to list possible wrongful death action against decedent's husband as an asset of decedent's estate, by continuing to represent the estate after administratrix also became the representative of decedent's husband when he committed suicide, and by colluding with other defendants, stated a cause of action in tort for attorney malpractice. Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984).

This section controls over the provisions of the Workers' Compensation Act, G.S. 97-1 et seq. Byers v. North Carolina State Hwy. Comm'n, 3 N.C. App. 139, 164 S.E.2d 535 (1968), aff'd on other grounds, 275 N.C. 229, 166 S.E.2d 649 (1969).

Workers' Compensation Act does not create two causes of action, one for the employee's estate and the other for the employer and insurance carrier. The right to bring action for damages for wrongful death is conferred by this section. The compensation act merely governs the respective rights of the employee's estate, the employer and the insurance carrier to maintain an action for damages against third parties. Groce v. Rapidair, Inc., 305 F. Supp. 1238 (W.D.N.C. 1969).

No Conflict with § 97-10.2(f)(1)c. — There is no conflict in the language in this section which prohibits use of the wrongful death recovery to pay a debt of the decedent and the language in G.S. 97-10.2(f)(1)c which directs that a portion of the recovery be applied to the reimbursement of the employer for benefits paid under award of the Industrial Commission. Byers v. North Carolina State Hwy. Comm'n, 3 N.C. App. 139, 164 S.E.2d 535 (1968), aff'd on other grounds, 275 N.C. 229, 166 S.E.2d 649 (1969).

If an employee's action would be barred by the Workers' Compensation Act, then a wrongful death action brought by the employee's representative is also barred. McAllister v. Cone Mills Corp., 88 N.C. App. 577, 364 S.E.2d 186 (1988).

Complaint Barred by Workers' Compensation Act. — Wrongful death complaint alleging that defendant, decedent's employer, negligently required decedent to perform tasks which exposed decedent to known carcinogens, thereby causing decedent's cancer of the bladder and resulting death, came within the language of G.S. 97-53(13) and was barred by the Workers' Compensation Act. McAllister v. Cone Mills Corp., 88 N.C. App. 577, 364 S.E.2d 186 (1988).

Liability to the general public of a host for the torts of his intoxicated guest. See Chastain v. Litton Sys., 694 F.2d 957 (4th Cir. 1982), cert. denied, 462 U.S. 1106, 103 S. Ct. 2454, 77 L. Ed. 2d 1334 (1983).

Employer's Liability for Death Caused by Employee Who Became Intoxicated at Company Party. — See Chastain v. Litton Sys., 694 F.2d 957 (4th Cir. 1982), cert. denied, 462 U.S. 1106, 103 S. Ct. 2454, 77 L. Ed. 2d 1334 (1983).

Claim Against Provider of Alcohol Barred by Decedent's Negligence. — Plaintiff's wrongful death claim against a provider of alcohol alleging wilful and wanton negligence for serving the visibly intoxicated decedent alcohol after being requested to refrain from serving him was barred by the decedent's own actions in driving his vehicle while highly intoxicated. Sorrells v. M.Y.B. Hospitality Ventures, 332 N.C. 645, 423 S.E.2d 72 (1992).

Personal Representative Has Authority and Responsibility. — The personal representative who institutes a wrongful death action is not a mere figurehead or naked trustee but has authority as well as responsibility. First Union Nat'l Bank v. Hackney, 266 N.C. 17, 145 S.E.2d 352 (1965); Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972).

Authority to Compromise. — Ordinarily, an executor or administrator has the right to compromise any disputed or doubtful claim of his decedent provided he acts honestly and exercises the care of an ordinarily prudent person, and this rule is applicable to a purely statutory cause of action for wrongful death. McGill v. Bison Fast Freight, Inc., 245 N.C. 469, 96 S.E.2d 438 (1957).

An administrator has the right to compromise a disputed claim if he acts in good faith and exercises the care which an ordinarily sensible and prudent man would exercise in dealing with his own property under like circumstances. Forsyth County v. Barneycastle, 18 N.C. App. 513, 197 S.E.2d 576, cert. denied, 283 N.C. 752, 198 S.E.2d 722 (1973).

A covenant not to sue, procured by one tort-feasor, does not release the other from liability. Kendrick v. Cain, 272 N.C. 719, 159 S.E.2d 33 (1968).

But a release of one joint tort-feasor ordinarily releases them all. Kendrick v. Cain, 272 N.C. 719, 159 S.E.2d 33 (1968).

Action Not Maintained Since Children Could Not Have Recovered For Injuries If They Had Lived. — The cause of action for the children's wrongful death, where the children were killed by their mother and her boyfriend as they were fleeing from police shortly before the truck they were in was blown up during the course of a gun battle and high speed chase with police, could not be maintained because the children could not have recovered for their injuries if they had lived, and the first requisite of a wrongful death action in this State is that the decedent could have recovered for his injuries if he had lived. Lynch v. North Carolina Dep't of Justice, 93 N.C. App. 57, 376 S.E.2d 247 (1989).

Action Against Pharmacist. — While a pharmacist has no duty to advise absent knowledge of the circumstances, once a pharmacist is alerted to specific facts and he or she undertakes to advise a customer, the pharmacist then has a duty to advise correctly; therefore, where plaintiff alleged, among other things, that her decedent "sought out and was relying upon the skill, judgment and expertise of defendant with respect to the safety of taking the drug Indocin given the fact that plaintiff's intestate suffered the aforementioned medical condition," she stated a claim upon which relief could be granted. Ferguson v. Williams, 92 N.C. App. 336, 374 S.E.2d 438 (1988).

Action Against Physician Barred by Settlement with Original Tort-Feasors. — Where a plaintiff institutes an action to recover damages for the wrongful death of his intestate against persons alleged to be solely responsible for intestate's injuries and death, and thereafter the action is compromised by the entry of a consent judgment for a substantial sum, the judgment is a bar to the plaintiff's right to maintain a subsequent action for the wrongful death of his intestate against a physician or surgeon for negligent treatment of the original injuries, such treatment being known to plaintiff when the first suit was filed. Bell v. Hankins, 249 N.C. 199, 105 S.E.2d 642 (1958).

Writ of Attachment May Issue. — A writ of attachment will issue under G.S. 1-440.1 to enforce the right created by this section. Mitchell v. Talley, 182 N.C. 683, 109 S.E. 882 (1921).

Nonsuit. — In a civil action under this and the succeeding section to recover damages for alleged wrongful death, where issues of fact are raised which the jury alone may decide, it is error for the court to allow a motion for judgment as of nonsuit. Henson v. Wilson, 225 N.C. 417, 35 S.E.2d 245 (1945).

Nonsuit held proper in action for wrongful death resulting when intestate drove into the side of a train which had been standing at nighttime, blocking the crossing, for some 30 seconds prior to the injury, with its ground lights, its platform light, and cab lights burning. Morris v. Winston-Salem Southbound Ry., 265 N.C. 537, 144 S.E.2d 598 (1965).

The burden of proving actionable negligence in an action for damages for wrongful death grounded in negligence is, of course, on the party seeking recovery. But if the evidence, that offered by both plaintiff and defendant, construed in the light most favorable to the party with the burden of proof, is sufficient to make out a prima facie case of actionable negligence, a motion for nonsuit should be denied and the case submitted to the jury. Maynor v. Townsend, 2 N.C. App. 19, 162 S.E.2d 677 (1968).

Directed Verdict. — In an action for wrongful death, a directed verdict for the defendant on the ground of contributory negligence should be granted when, and only when, the evidence, taken in the light most favorable to plaintiff, establishes the contributory negligence of plaintiff's intestate so clearly that no other reasonable inference or conclusion may be drawn therefrom. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Citizenship of Beneficiaries Is Controlling for Diversity Purposes. — When a resident ancillary administrator is required to represent the interests of noncitizen beneficiaries by virtue of the laws of the state in which the claim arose, and his duties are as limited as those imposed upon him by this section, the citizenship of the beneficiaries is controlling for diversity purposes. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

The citizenship of the administrator does not defeat diversity jurisdiction in an action under this section brought by a North Carolina ancillary administrator against North Carolina defendants to recover for the death of a nonresident for the benefit of nonresident distributees. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

Noncitizen Entitled to Federal Forum. — Diversity jurisdiction exists for the protection of the noncitizen who is obliged to sue or to be sued in the state of his adversary. It is for that reason that state statutes or decisions that require a noncitizen to appoint an in-state representative should not have the effect of depriving the noncitizen of the federal forum that Congress has provided him. Miller v. Perry, 456 F.2d 63 (4th Cir. 1972).

Payment of Expenses of Suit from Assets of Estates. — With the 1985 amendment of subsection (a) of this section, the Legislature has chosen to allow reasonable and necessary expenses, excluding attorneys' fees, incurred in pursuing a wrongful death action to be paid from the assets of the deceased's estate. If there is any recovery from the wrongful death action, the recovery must first be applied to reimburse the estate for the expenses paid from its assets in pursuing the action. In re Estate of Proctor, 79 N.C. App. 646, 340 S.E.2d 138 (1986).

Prior to the 1985 amendment to subsection (a) of this section, there was no statutory authority for paying out of a decedent's estate the reasonable and necessary expenses incurred in pursuing a wrongful death action. Thus, on February 1, 1985, clerk properly denied petition seeking authorization of payment of litigation expenses out of decedent's estate, and superior court was correct in affirming the clerk's order. However, following the July 5, 1985 amendment there was nothing to prevent decedent's personal representatives from filing a new petition seeking to have those same expenses paid from the deceased's estate. In re Estate of Proctor, 79 N.C. App. 646, 340 S.E.2d 138 (1986).

Contributory negligence of decedent, who was operating his vehicle in an impaired condition in violation of G.S. 20-138.1, was a defense to a wrongful death claim under this section based on defendants' alleged negligence in selling alcohol to an intoxicated person. Clark v. Inn W., 89 N.C. App. 275, 365 S.E.2d 682, rev'd on other grounds, 324 N.C. App. 415, 379 S.E.2d 23 (1989).

Effect of Medicare. — The Wrongful Death Act's $1,500 limitation on a health care provider's right to recover a decedent's medical expenses is preempted by Medicare's secondary payer provisions. Cox v. Shalala, 112 F.3d 151 (4th Cir. 1997).

Jury Issues Raised. — Personal representative's wrongful death and survivorship claims could be brought in the same suit and separate issues should have been presented to the jury on whether a nursing home's negligence caused the decedent's pre-death injuries and wrongful death; the nursing home's claim that a personal representative was required to delineate which of the decedent's pressure sores caused his death and which sores caused him pain and suffering prior to his death was rejected as if the jury determined that the decedent died of Alzheimer's disease, rather than from an infection from the pressure sores, it could still reasonably determine that the nursing home's negligence caused the pressure sores and that any or all of those sores caused the decedent pain and suffering prior to his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Alterantive Survivorship and Wrongful Death Claims. — Wrongful death and survivorship claims may be brought as alternative claims for the same negligent acts. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Survivorship and Wrongful Death Actions Properly Alleged. — Personal representative was entitled to proceed on both a survivorship claim and a wrongful death claim where he alleged that a nursing home's negligence resulted not only in the decedent's death, but also in injury, pain and suffering, and medical expenses prior to his death. Alston v. Britthaven, Inc., 177 N.C. App. 330, 628 S.E.2d 824, 2006 N.C. App. LEXIS 943 (2006).

Action Erroneously Brought Under Survivorship Statute. — Trial court properly granted summary judgment to defendant as to an insurance company's action under the survivorship statute, G.S. 28A-18-1, because the claim was based on a single negligent act of defendant, and thus the sole remedy available was under the wrongful death statute, G.S. 28A-18-2, and any wrongful death action was barred by the statute of limitations under G.S. 1-53(4). State Auto Ins. Co. v. Blind, — N.C. App. —, 650 S.E.2d 25, 2007 N.C. App. LEXIS 1940 (2007).

Applied in Williams v. GMC, 393 F. Supp. 387 (M.D.N.C. 1975); Pinkston v. Baldwin, Lima, Hamilton Co., 292 N.C. 260, 232 S.E.2d 431 (1977); Hinton v. City of Raleigh, 46 N.C. App. 305, 264 S.E.2d 777 (1980); Hairston v. Alexander Tank & Equip. Co., 310 N.C. 227, 311 S.E.2d 559 (1984); Williams v. Odell, 90 N.C. App. 699, 370 S.E.2d 62 (1988); Ward v. McDonald, 100 N.C. App. 359, 396 S.E.2d 337 (1990); Locklear v. Nixon, 129 N.C. App. 105, 497 S.E.2d 310 (1998); Bailey v. Gitt, 135 N.C. App. 119, 518 S.E.2d 794 (1999).

Cited in Smith v. State, 289 N.C. 303, 222 S.E.2d 412 (1976); Sadler v. New Hanover Mem. Hosp., 432 F. Supp. 604 (E.D.N.C. 1977); Holt v. City of Statesville, 35 N.C. App. 381, 241 S.E.2d 362 (1978); Messer v. American Gems, Inc., 612 F.2d 1367 (4th Cir. 1980); Davis v. Piper Aircraft Corp., 615 F.2d 606 (4th Cir. 1980); Nicholson v. Hugh Chatham Mem. Hosp., 300 N.C. 295, 266 S.E.2d 818 (1980); Waller v. Butkovich, 584 F. Supp. 909 (M.D.N.C. 1984); McDowell v. Estate of Anderson, 69 N.C. App. 725, 318 S.E.2d 258 (1984); In re Ragan, 64 Bankr. 384 (Bankr. E.D.N.C. 1986); Woodson v. Rowland, 92 N.C. App. 38, 373 S.E.2d 674 (1988); State v. Beale, 324 N.C. 87, 376 S.E.2d 1 (1989); Clark v. Inn W., 324 N.C. 415, 379 S.E.2d 23 (1989); Woodson v. Rowland, 329 N.C. 330, 407 S.E.2d 222 (1991); Greer v. Parsons, 331 N.C. 368, 416 S.E.2d 174 (1992); Westinghouse v. Hair, 107 N.C. App. 106, 418 S.E.2d 532 (1992); Doe v. American Nat'l Red Cross, 837 F. Supp. 121 (E.D.N.C. 1992); Horne v. Owens-Corning Fiberglas Corp., 4 F.3d 276 (4th Cir. 1993); Jones v. Rochelle, 125 N.C. App. 82, 479 S.E.2d 231 (1996); Cissell v. Glover Landscape Supply, Inc., 126 N.C. App. 667, 486 S.E.2d 472 (1997); Estate of Darby v. Monroe Oil Co., 127 N.C. App. 301, 488 S.E.2d 828 (1997), cert. denied, 347 N.C. 397, 494 S.E.2d 602 (1997); Locklear v. Nixon, 129 N.C. App. 105, 497 S.E.2d 310 (1998); Friedland v. Gales, 131 N.C. App. 802, 509 S.E.2d 793 (1998); Olvera v. Edmundson, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 15284 (W.D.N.C. Sept. 21, 2001); Beyer v. N.C. Div. of Mental Health, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 16968 (W.D.N.C. Oct. 16, 2001); In re Estate of Lunsford, 143 N.C. App. 646, 547 S.E.2d 483, 2001 N.C. App. LEXIS 326 (2001), cert. granted, 353 N.C. 727, 550 S.E.2d 779 (2001); McKinney v. Richitelli, 357 N.C. 483, 586 S.E.2d 258, 2003 N.C. LEXIS 1097 (2003); Locust v. Pitt County Mem'l Hosp., Inc., 358 N.C. 113, 591 S.E.2d 543, 2004 N.C. LEXIS 20 (2004); In re J.A.A., 175 N.C. App. 66, 623 S.E.2d 45, 2005 N.C. App. LEXIS 2706 (2005); Beck v. Beck, 175 N.C. App. 519, 624 S.E.2d 411, 2006 N.C. App. LEXIS 178 (2006).

II. LIMITATION OF THE ACTION.

Two-year Limitation. — The period prescribed for the commencement of an action for wrongful death under this section is two years. High v. Broadnax, 271 N.C. 313, 156 S.E.2d 282 (1967), overruled on other grounds, Bockweg v. Anderson, 328 N.C. 436, 402 S.E.2d 627 (1991).

Former Time Limit Was Condition Precedent Rather than Statute of Limitation. — Up to the time of the amendments of 1951 to the former wrongful death statute and G.S. 1-53, it had consistently been held that the time limitation in this section was not a statute of limitations, but rather a condition precedent to maintenance of an action. The effect of the amendments was to remove from the Wrongful Death Act the time limitation and make the act subject to the statute of limitations of two years in G.S. 1-53. McCrater v. Stone & Webster Eng'r Corp., 248 N.C. 707, 104 S.E.2d 858 (1958).

Prior to the enactment of G.S. 1-53(4), and the 1951 amendment to the former wrongful death statute, the institution of an action for wrongful death within one year after such death was a condition precedent to maintaining the action. All other requirements of the section were also strictly construed. The amendment removed the time limitation as a condition annexed to the cause of action and made it a two-year statute of limitations. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963).

Since the enactment of the 1951 amendment to the former wrongful death statute, the time within which a wrongful death action may be commenced is not an integral part of the right of action or a condition precedent thereto but is an ordinary (two-year) statute of limitations under G.S. 1-53(4). Stamey v. Rutherfordton Elec. Membership Corp., 249 N.C. 90, 105 S.E.2d 282 (1958).

Section 1-53 and the former wrongful death statute were amended in 1951 so as to remove from the latter section the provision previously contained therein fixing the period of time in which an action for damages for wrongful death must be instituted and so as to make such action subject to the two-year statute of limitations set forth in G.S. 1-53. The effect of the amendment was to make the time limitation a statute of limitations and no longer a condition precedent to the right to bring and maintain the action. Kinlaw v. Norfolk S. Ry., 269 N.C. 110, 152 S.E.2d 329 (1967).

Delay Less Than Period Is Not Laches of Itself. — Mere delay of petitioner in commencing his action for damages for wrongful death, which does not amount to a bar of the statute of limitations, does not of itself constitute laches, where the delay has not worked an injury or prejudice or disadvantage to the administratrix c.t.a. of the estate, and the clerk has found no facts that petitioner's delay would work prejudice or injury to the estate of the deceased. In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

Action by Ancillary Administrator. — The fact that an action for wrongful death is brought by an ancillary administrator appointed in this State does not constitute the action accruing to a resident of this State within the meaning of the proviso to G.S. 1-21. Broadfoot v. Everett, 270 N.C. 429, 154 S.E.2d 522 (1967).

Where a complaint to recover damages under a state wrongful death act was timely filed by an ancillary administrator appointed by a state court without jurisdiction to do so, the complaint could be amended under G.S. 1A-1, Rule 17(a) at a time when a new suit would be barred so as to allege the subsequent effective appointment of the same person as ancillary administrator by a state court having jurisdiction. McNamara v. Kerr-McGee Chem. Corp., 328 F. Supp. 1058 (E.D.N.C. 1971).

Amendment Not Introducing New Cause of Action. — Where, in an action for wrongful death, the complaint discloses that the action was instituted within the statutory period, but plaintiff is thereafter permitted to amend the defective statement of his good cause of action by particularizing the acts of negligence complained of, the amendment does not introduce a new cause of action, and the cause is not barred by this section. Davis v. Rhodes, 231 N.C. 71, 56 S.E.2d 43 (1949).

Amendment or Substitution of Proper Party Relates Back. — Amendment or substitution of the proper party under G.S. 1A-1, Rule 15(a) and (c) and G.S. 1A-1, Rule 17(a), may be made at any time before hearing to cure a lack of letters of administration, and later appointments of this nature will relate back and validate the proceedings from the beginning regardless of the statute of limitations. McNamara v. Kerr-McGee Chem. Corp., 328 F. Supp. 1058 (E.D.N.C. 1971).

Action Commenced upon False Allegation of Appointment Cannot Be Validated Following Expiration of Statute of Limitations. — A party who has not been appointed as administratrix and has not offered herself for qualification may not, upon a false allegation that she has qualified as administratrix, commence an action for wrongful death and, following the expiration of the statute of limitations, validate that action by a subsequent appointment as administratrix. Reid v. Smith, 5 N.C. App. 646, 169 S.E.2d 14 (1969).

Collateral estoppel precluded plaintiffs from bringing a wrongful death action against police officer, where an earlier federal district court decision found that the defendant was entitled to qualified immunity regarding plaintiffs' federal constitutional claims because "a reasonable officer in the same situation as [defendant] could have found probable cause to believe that [the decedent] posed a deadly threat, and, therefore, that [defendant] would have been authorized to use deadly force to protect himself," thereby raising an issue identical to the issue raised in plaintiffs' wrongful death action, the standard of defendant's conduct under the circumstances. Estate of Fennell v. Stephenson, 37 N.C. App. 430, 528 S.E.2d 911, 2000 N.C. App. LEXIS 428 (2000).

But Action Commenced under Mistaken Belief of Appointment May Be Validated by Subsequent Appointment. — Where a widow institutes an action as administratrix, for damages for the wrongful death of her husband, under the mistaken belief that she had been duly appointed and had qualified as such, thereafter discovers her error and amends her petition so as to show that she was appointed administratrix after the expiration of the statute of limitations applicable to such action, the amended petition will relate back to the date of the filing of the petition, and the action will be deemed commenced within the time limited by statute. Reid v. Smith, 5 N.C. App. 646, 169 S.E.2d 14 (1969).

Widow's belated qualification as administratrix did not relate back to the date of the filing of the suit when no attempt was previously made to qualify as administrator in North Carolina. Johnson v. Wachovia Bank & Trust Co., 22 N.C. App. 8, 205 S.E.2d 353 (1974).

Medical Malpractice. — Four year statute of repose for medical malpractice actions, G.S. 1-15(c) (2003), applied to wrongful death cases; a wrongful death medical malpractice suit filed within two years of decedent's death, but more than four years after doctor's last act, was properly dismissed as untimely. Udzinski v. Lovin, 358 N.C. 534, 597 S.E.2d 703, 2004 N.C. LEXIS 658 (2004).

Wrongful death suit was stayed pending binding arbitration because plaintiff, as administrator of a decedent's estate, failed to establish any contract defenses that would have otherwise invalidated the arbitration agreement entered into by the decedent regarding her medical treatment for benign liver tumors; because decedent's ability to recover was limited in form to arbitration by her execution of the agreement with defendants, her estate was equally bound by the arbitration agreement. Wilkerson v. Nelson, 395 F. Supp. 2d 281, 2005 U.S. Dist. LEXIS 11212 (M.D.N.C. 2005).

III. PARTIES TO THE ACTION.

Decedent's personal representative is the proper party plaintiff in a wrongful death action. Brendle v. General Tire & Rubber Co., 408 F.2d 116 (4th Cir. 1969).

Suit Must Be Brought by Personal Representative. — The personal representative of the deceased, his executor or administrator, etc., can alone maintain an action for damages for his wrongful death under the provisions of this section. Hanes v. Southern Pub. Utils. Co., 191 N.C. 13, 131 S.E. 402 (1926). See Hood v. AT & T Co., 162 N.C. 70, 77 S.E. 1096 (1913); White v. Holding, 217 N.C. 329, 7 S.E.2d 825 (1940).

While any sum recovered is not a part of decedent's estate, such sum can only be recovered in the name of the personal representative, and must be distributed under laws of intestacy in this State. Harrison v. Carter, 226 N.C. 36, 36 S.E.2d 700 (1946), citing Neill v. Wilson, 146 N.C. 242, 59 S.E. 674 (1907); Hines v. Foundation Co., 196 N.C. 322, 145 S.E. 612 (1928).

Action for wrongful death may be brought only by the executor, administrator, or collector of the decedent. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963); First Union Nat'l Bank v. Hackney, 266 N.C. 17, 145 S.E.2d 352 (1965); Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972); Merchants Distrib., Inc. v. Hutchinson, 16 N.C. App. 655, 193 S.E.2d 436 (1972); Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973); Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

The right of action conferred by this section vests in the personal representative of the deceased. Horney v. Meredith Swimming Pool Co., 267 N.C. 521, 148 S.E.2d 554 (1966); Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968); Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972).

Nobody other than the executor, administrator, or collector of an estate can maintain an action for wrongful death. Young v. Marshburn, 10 N.C. App. 729, 180 S.E.2d 43, cert. denied, 278 N.C. 703, 181 S.E.2d 603 (1971).

Under this section, the only person who can sue is the personal representative of the deceased. Journigan v. Little River Ice Co., 233 N.C. 180, 63 S.E.2d 183 (1951).

The right of action under this section is for the personal representative of the deceased only. The right of action for wrongful death, being conferred by statute at death, never belonged to the deceased. Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972).

Under the Wrongful Death Act, the administrator of an intestate, or the executor of one who dies testate, may institute an action for wrongful death; and he does so as the representative of the estate. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

In His Official Capacity. — The statute requires the suit to be brought by the administrator in his official and not in his private or individual capacity. He must sue as administrator. Hall v. Southern R.R., 146 N.C. 345, 59 S.E. 879 (1907).

The personal representative alone can maintain the action, and only in his official capacity. He sues in his own right and not en autre droit. McCoy v. Atlantic Coast Line R.R., 229 N.C. 57, 47 S.E.2d 532 (1948). See Christian v. Atlantic & N.C.R.R., 136 N.C. 321, 48 S.E. 743 (1904).

Widow, as such, has no right of action for death of her husband. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963).

Under this section an action cannot be maintained by a widow as such, but must be brought by the personal representative of the deceased. Bennett v. North Carolina R.R., 159 N.C. 345, 74 S.E. 883 (1912); Craig v. Suncrest Lumber Co., 189 N.C. 137, 126 S.E. 312 (1925).

Nor husband for wife's death. — A husband as such cannot sue for the wrongful death of his wife. Hood v. AT & T Co., 162 N.C. 70, 77 S.E. 1096 (1913).

Nor parent for death of child. — A father cannot maintain an action in his individual capacity for the death of his son. Killian v. Southern R.R., 128 N.C. 261, 38 S.E. 873 (1901).

Action by the personal representative of deceased stillborn child was not barred by the release executed by child's parents, as the release by its terms bound only themselves and their heirs and assigns as to their personal claims and did not purport to settle or affect a claim for the child's wrongful death, and since under North Carolina law the parents, though the child's next of kin, had no authority to either assert or settle a claim for the child's wrongful death; only the child's personal representative had that authority. Greer v. Parsons, 103 N.C. App. 463, 405 S.E.2d 921, aff'd, 331 N.C. 368, 416 S.E.2d 174 (1992).

A father cannot maintain an action in his individual capacity for the wrongful death of his daughter resulting from seduction. Scarlett v. Norwood, 115 N.C. 284, 20 S.E. 459 (1894).

Action by One Not Personal Representative Should Be Dismissed. — If an action for wrongful death is instituted by one other than the personal representative of a decedent, duly appointed in this State, it should be dismissed, and a separate and independent action instituted by such representative. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963); Merchants Distrib., Inc. v. Hutchinson, 16 N.C. App. 655, 193 S.E.2d 436 (1972).

If an action for wrongful death is instituted by one other than the personal representative of a decedent, duly appointed in this State, it should be dismissed. Young v. Marshburn, 10 N.C. App. 729, 180 S.E.2d 43, cert. denied, 278 N.C. 703, 181 S.E.2d 603 (1971).

And Court Has No Authority to Convert It to New Action by Admission of Party. — The court has no authority, over objection, to convert a pending action for wrongful death which cannot be maintained into a new and independent action by admitting a party who is solely interested as plaintiff. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963).

Action Commences from Time Personal Representative Joined. — Should the personal representative be permitted to become a party to an unauthorized action for wrongful death, the action is deemed to have been commenced only from the time he became a party. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963).

The real party in interest in an action under this section is not the administrator, but the beneficiary under the statute for whom the recovery is sought. Davenport v. Patrick, 227 N.C. 686, 44 S.E.2d 203 (1947); In re Ives' Estate, 248 N.C. 176, 102 S.E.2d 807 (1958).

Although an action for wrongful death must be brought by the personal representative of the deceased, the personal representative is not the real party in interest and the action does not accrue in his favor. Broadfoot v. Everett, 270 N.C. 429, 154 S.E.2d 522 (1967).

The personal representative of a decedent, as such, has no beneficial interest in a recovery and is therefore not the real party in interest. Long v. Coble, 11 N.C. App. 624, 182 S.E.2d 234, cert. denied, 279 N.C. 395, 183 S.E.2d 246 (1971).

In a wrongful death action, the real parties in interest were the beneficiaries as defined in the Wrongful Death Act, who were the same persons who would have received property had the decedent died intestate; where a widow, who was the decedent's sole intestate beneficiary, had abandoned the decedent before his death, she was not entitled to a wrongful death recovery, and since the remaining beneficiaries did not succeed to a full 100 percent, but only received their original percentage, there were no beneficiaries to the wrongful death claim. Locust v. Pitt County Mem'l Hosp., 154 N.C. App. 103, 571 S.E.2d 668, 2002 N.C. App. LEXIS 1410 (2002), cert. denied, 356 N.C. 673, 579 S.E.2d 272 (2003).

Necessity for Proof Where Plaintiff's Capacity Denied. — Nonsuit is properly entered in an action for wrongful death when plaintiff's allegation that she was duly qualified and acting administratrix of the deceased is denied in the answer and plaintiff offers no evidence in support of her allegation. Carr v. Lee, 249 N.C. 712, 107 S.E.2d 544 (1959).

False Allegation of Appointment Cannot Be Validated by Subsequent Appointment. — One who has never applied for letters of administration or who, having applied, has no reasonable grounds for believing that he had been duly appointed, cannot institute an action for wrongful death, or any other cause, upon a false allegation of appointment and thereafter validate that allegation by a subsequent appointment. Graves v. Welborn, 260 N.C. 688, 133 S.E.2d 761 (1963); Reid v. Smith, 5 N.C. App. 646, 169 S.E.2d 14 (1969).

Amendment to Substitute Proper Party Allowed. — Under G.S. 1A-1, Rule 15(a) and (c), and G.S. 1A-1, Rule 17(a), a lack of letters of administration may be cured, and an objection to want of capacity to sue may be avoided by amendment or by substitution of the proper party at any time before hearing. McNamara v. Kerr-McGee Chem. Corp., 328 F. Supp. 1058 (E.D.N.C. 1971).

A cause of action under this section is sufficient for the appointment of an administrator. Vance v. Southern R.R., 138 N.C. 460, 50 S.E. 860 (1905).

As to appointment of ancillary administrator, see Merchants Distrib., Inc. v. Hutchinson, 16 N.C. App. 655, 193 S.E.2d 436 (1972).

Foreign administrator lacks capacity to sue in a wrongful death action in this State. Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Where a deceased has left a will naming an executor, and disposing of all his property, the right of action for his wrongful death must be by the executor named. Hood v. AT & T Co., 162 N.C. 70, 77 S.E. 1096 (1913).

Complaint of Unqualified Administratrix Held Demurrable. — Where an action for wrongful death was instituted in this State by an unqualified administratrix, the defect could be taken advantage of by demurrer, since such plaintiff did not have legal capacity to sue and thus the complaint did not state facts sufficient to constitute a cause of action. Monfils v. Hazlewood, 218 N.C. 215, 10 S.E.2d 673 (1940), cert. denied, 312 U.S. 684, 61 S. Ct. 612, 85 L. Ed. 1122 (1941).

Executor May Not Be Joined as Defendant. — In a wrongful death action, a motion by the plaintiff, who was the adopted daughter of the decedent, that the executor of the estate of the decedent be joined as a defendant was denied because the executor is not a proper party to be joined as a defendant in an action which he alone by statute is authorized to commence. Young v. Marshburn, 10 N.C. App. 729, 180 S.E.2d 43, cert. denied, 278 N.C. 703, 181 S.E.2d 603 (1971).

Action by Representative of Employee Covered by Workers' Compensation. — Although an administratrix of a deceased employee who has received compensation for the employee's death under the provisions of the Workers' Compensation Act is thereby barred from prosecuting any other remedy for the injury, she may, under this section, pending the hearing before the Industrial Commission, institute an action against a third person whose negligent acts caused the death of the intestate, and where the insurance carrier has paid the compensation later awarded, it is subrogated to the rights of the employer and may maintain the action against such third person in the name of the administratrix. Phifer v. Berry, 202 N.C. 388, 163 S.E. 119 (1932).

Since the North Carolina Workers' Compensation Act expressly provides that the subrogated right of action against the third person tort-feasor in favor of the insurance carrier paying compensation for which the employer is liable must be maintained in the name of the injured employee or his personal representative, the act does not change or modify the requirement of this section that an action for wrongful death must be maintained by the administrator of the deceased, and the insurance carrier cannot maintain the action for wrongful death in its own name against the third person tort-feasor. Whitehead v. Branch, 220 N.C. 507, 17 S.E.2d 637 (1941). See also Brown v. Southern R.R., 202 N.C. 256, 162 S.E. 613 (1932).

The administrator of an employee within the Workers' Compensation Act cannot sue the employer for the wrongful death of the employee since the employee could not have sued the employer for his injury had he lived. Raftery v. Wm. C. Vick Constr. Co., 291 N.C. 180, 230 S.E.2d 405 (1976).

Action by Child Born Alive. — Since the child must carry the burden of infirmity that results from another's tortious act, it is only natural justice that it, if born alive, be allowed to maintain an action on the ground of actionable negligence. Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968).

Prenatal Death of Viable Child. — This section allows recovery for the death of a viable but unborn child. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987), reversing DiDonato v. Wortman, 80 N.C. App. 117, 341 S.E.2d 58 (1986).

The Supreme Court's holding in DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489 (1987), permitting an action to recover for the destruction of a viable fetus en ventre sa mere, could be applied retroactively to an action commenced before DiDonato was decided. Johnson v. Ruark Obstetrics & Gynecology Assocs., 89 N.C. App. 154, 365 S.E.2d 909 (1988), aff'd, 327 N.C. 283, 395 S.E.2d 85 (1990).

The definition of "viability" intended by the Supreme Court in DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489 (1987), is simply the common law definition of fetal capability to live independently of the mother. Although there is apparently no clear medical consensus as to the specific gestational age at which this capability is currently achieved, a gestational range of 20 to 26 weeks has been suggested. However, the determination of a fetus's viability is a question of fact. Johnson v. Ruark Obstetrics & Gynecology Assocs., 89 N.C. App. 154, 365 S.E.2d 909 (1988), aff'd, 327 N.C. 283, 395 S.E.2d 85 (1990).

Action by Administrator of Unemancipated Child Against Parents. — An unemancipated child living with his parents may not maintain an action in tort against them, nor can the administrator of the child recover damages against them for the child's wrongful death, as this section gives a right of action for wrongful death only where the injured party, if he had lived, could have maintained such action. Goldsmith v. Samet, 201 N.C. 574, 160 S.E. 835 (1931); Lewis v. Farm Bureau Mut. Auto. Ins. Co., 243 N.C. 55, 89 S.E.2d 788 (1955).

The administrator of an unemancipated minor child killed by the negligence of his parent has no cause of action against the parent for the wrongful death of his intestate. Capps v. Smith, 263 N.C. 120, 139 S.E.2d 19 (1964); First Union Nat'l Bank v. Hackney, 266 N.C. 17, 145 S.E.2d 352 (1965).

The right of action for wrongful death is limited to such as would, if the injured party had lived, have entitled him to an action for damages therefor. Hence, the administrator of an unemancipated child whose death is caused by the negligence of his parent has no cause of action against the parent for the wrongful death of the child because such child, if he had lived, would have had no cause of action against the parent on account of his injuries. Horney v. Meredith Swimming Pool Co., 267 N.C. 521, 148 S.E.2d 554 (1966).

The administrator of an unemancipated minor child may not bring an action against the administrator of its father for damages for the wrongful death of such child caused by the ordinary negligence of the deceased father. Skinner v. Whitley, 281 N.C. 476, 189 S.E.2d 230 (1972).

Same — Motor Vehicle Cases. — Except as G.S. 1-539.21 now provides, the administrator of an unemancipated minor child cannot bring an action for wrongful death against the child's negligent parent. Raftery v. Wm. C. Vick Constr. Co., 291 N.C. 180, 230 S.E.2d 405 (1976).

The administrator of a deceased minor's estate may maintain an action on the dead child's behalf for wrongful death against the negligent parent-driver of the vehicle through this section and G.S. 1-539.21 which abolished parent-child immunity in motor vehicle cases. Carver v. Carver, 55 N.C. App. 716, 286 S.E.2d 799, cert. denied, 305 N.C. 584, 292 S.E.2d 569 (1982), rev'd on other grounds, 310 N.C. 669, 314 S.E.2d 739 (1984).

It is not G.S. 1-539.21 standing alone which abrogates parental immunity in wrongful death actions arising out of the operation of motor vehicles; it is G.S. 1-539.21 and this section, read in pari materia, which bring about this result. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

As G.S. 1-539.21 has abolished the doctrine of parental immunity in personal injury and property damage cases arising out of a parent's operation of a motor vehicle, the doctrine is no longer a bar to wrongful death actions by the deceased child's estate which likewise arise out of a parent's operation of a motor vehicle. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

When parental immunity would not have barred a personal injury action brought by the deceased child had he lived, it likewise does not bar a wrongful death action brought by his estate. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Action by Representative of Parent Against Unemancipated Child. — Neither a parent nor his personal representative has an action for wrongful death against an unemancipated child or his representative. Horney v. Meredith Swimming Pool Co., 267 N.C. 521, 148 S.E.2d 554 (1966).

Action by Administrator of Wife Against Husband. — If a husband's negligence results in the death of his wife, her personal representative may maintain an action against him for her wrongful death. Cox v. Shaw, 263 N.C. 361, 139 S.E.2d 676 (1965).

If a wife's death is caused by the actionable negligence of her husband, this section creates and authorizes an action by her personal representative to recover for her wrongful death. First Union Nat'l Bank v. Hackney, 266 N.C. 17, 145 S.E.2d 352 (1965).

Since G.S. 52-5 provides that an injured wife has a cause of action against her husband for damages for personal injury, under the provisions of this section the administrator of her estate may maintain an action for wrongful death when she does not survive. Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832, cert. denied, 279 N.C. 726, 184 S.E.2d 883 (1971).

Action Against Estate of One Causing Wrongful Death. — Where a person is alleged to have caused the death of another by his wrongful act, neglect, or default, and suit has been brought against him and is pending at his death within one year after the wrongful death caused by him, an action will lie against the executor and administrator of the deceased defendant under the provisions of this section. Tonkins v. Cooper, 187 N.C. 570, 122 S.E. 294 (1924).

When the death of a person is caused by a wrongful act, neglect or default of another, such as would, if the injured party had lived, have entitled him to an action for damages therefor and the person that would have been so liable dies, or is killed at the same time, then the action for damages for wrongful death survives the death of the tort-feasor against his executor or administrator. In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

Right to Have Discharge of Tort-Feasor's Administratrix Set Aside. — An administrator who institutes action for the wrongful death of his intestate within the statutory time against the estate of the deceased tort-feasor is entitled to have the order of the clerk discharging the administratrix of the deceased tort-feasor set aside by motion in the cause upon showing a policy of liability insurance in the hands of the administratrix of the deceased tort-feasor available for the payment of the claim. In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

Joinder of Employer with Employee. — Where the death is caused by the negligence of an employee while acting within the scope of his authority the employer may be joined as a defendant under the doctrine of respondeat superior. Brown v. Southern R.R., 202 N.C. 256, 162 S.E. 613 (1932).

Joinder of Joint Tort-Feasor as Party Defendant. — One of several defendants, in an action for wrongful death arising out of a joint tort, may have still another joint tort-feasor brought in and made a party defendant for the purpose of enforcing contribution, although plaintiff's right of action against such other tort-feasor, originally subsisting, has been lost by the lapse of time. Godfrey v. Tidewater Power Co., 223 N.C. 647, 27 S.E.2d 736 (1943).

Where plaintiff sues defendant under this section, alleging that her intestate was killed by his negligence, defendant may not join as a joint tort-feasor under former G.S. 1-240 a railway company by which the plaintiff's intestate was employed in interstate commerce. Wilson v. Massagee, 224 N.C. 705, 32 S.E.2d 335 (1944).

In a suit under the Federal Employers' Liability Act against defendant railroad, plaintiff was not permitted to join an additional defendant tort-feasor since there was no common legal right in the actions against the two. Bryant v. Atlantic C.L.R.R., 248 N.C. 43, 102 S.E.2d 393 (1958).

Municipalities Not Exempt from Section. — The plain, positive provisions of this section contain no basis for supposing that the Legislature intended to exempt municipalities therefrom. Jackson v. Housing Auth., 73 N.C. App. 363, 326 S.E.2d 295 (1985), aff'd, 316 N.C. 259, 341 S.E.2d 523 (1986).

A wrongful death action may be maintained against a municipal corporation. Jackson v. Housing Auth., 316 N.C. 259, 341 S.E.2d 523 (1986).

Actions Against County Employees. — Plaintiff's complaint, claiming that social services employees defendants' negligent failure to investigate claims of child abuse and neglect, coupled with their failure to remove her son from the custody of his abusive father caused her son's death, contained allegations pertaining only to the defendants' actions or inactions in their official capacities with county department of social services and that defendants were entitled to judgment based on governmental immunity. Whitaker v. Clark, 109 N.C. App. 379, 427 S.E.2d 142, cert. denied, 333 N.C. 795, 431 S.E.2d 31 (1993).

IV. DISTRIBUTION OF RECOVERY.

The North Carolina law is materially different from that of most states in that distribution is made, not to designated classes, but in accordance with the statute of distribution. McCoy v. Atlantic C.L.R.R., 229 N.C. 57, 47 S.E.2d 532 (1948).

Section Governs Nature and Distribution of Recovery. — The nature and distribution of whatever recovery is obtained is governed by the provisions of this section. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Distribution as if Decedent Died Intestate. — In the enactment of this section, the legislature intended that the proceeds of a recovery, or settlement, in an action for wrongful death shall be distributed to the same persons, and in the same proportionate shares, as the personal property of the decedent, remaining after the payment of all debts and other claims and expenses of administration, would be distributed if the decedent died intestate. Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

Where decedent's ex-spouse abandoned her interest in the decedent's estate at the time of death, decedent's siblings were entitled to share in any wrongful death proceeds, distribution was dictated by the laws of intestacy, and decedent's sister, as administratrix had standing to file the action. Locust v. Pitt County Mem'l Hosp., Inc., 358 N.C. 113, 591 S.E.2d 543, 2004 N.C. LEXIS 20 (2004).

Intestate Succession Act as Modified by Chapter 31A Intended. — When the legislature, in this section, provided that the proceeds of an action for wrongful death "shall be disposed of as provided in the Intestate Succession Act," and when it provided in G.S. 97-40 that the order of priority among claimants to death benefits payable under the Workers' Compensation Act "shall be governed by the general law applicable to the distribution of the personal estate of persons dying intestate," it had in mind the same law; i.e., the Intestate Succession Act as modified by Chapter 31A, entitled, "Acts Barring Property Rights." Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

Section 31A-2 must be deemed a part of the Intestate Succession Act and a modification of G.S. 29-15(3), as fully as if it had been written thereinto or specifically designated as an amendment thereto. Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

North Carolina's wrongful death statute mandates that wrongful death proceeds be distributed as provided in the Intestate Succession Act, G.S. 29-1 et seq., and they are therefore subject to G.S. 31A-2, under which an abandoning parent is precluded from sharing in such proceeds arising from the death of his or her child. In re Estate of Lunsford, 359 N.C. 382, 610 S.E.2d 366, 2005 N.C. LEXIS 358 (2005).

When Distribution in Accordance with Subsection (a) Not Appropriate. — Distribution of the recovery in accordance with subsection (a), although appropriate when the recovery is computed on the basis of the loss to the estate, is not appropriate when the recovery is based largely on losses suffered by particular beneficiaries. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Action Not Abated upon Death of Primary Beneficiary. — Although the Wrongful Death Act was amended drastically in some respects in 1969, there was absolutely no change in the basic portions allowing the action and providing for the disposition of the recovery. There is nothing in the amended statute which would, in any way, indicate any intent on the part of the legislature that a wrongful death action should abate upon the death of the primary beneficiary pending determination of the action. Willis v. Duke Power Co., 42 N.C. App. 582, 257 S.E.2d 471 (1979).

Recovery Held in Trust. — The administrator holds the amount recovered in trust for those that may be entitled thereto as distributees. Baker v. Raleigh & Gaston R.R., 91 N.C. 308 (1884); Avery v. Brantley, 191 N.C. 396, 131 S.E. 721 (1926); In re Ives' Estate, 248 N.C. 176, 102 S.E.2d 807 (1958).

In receiving funds paid in settlement of a wrongful death claim a personal representative of a decedent's estate is not acting for the estate but as the trustee for the beneficiaries under the law. In re Estate of Below, 12 N.C. App. 657, 184 S.E.2d 378 (1971).

A personal representative does not derive any right, title, or authority from his intestate, but he sustains more the relation of a trustee in respect to the fund he may recover for the benefit of those entitled eventually to receive it, and he will hold it when recovered actually in that capacity, though in his name as executor or administrator. In re Estate of Below, 12 N.C. App. 657, 184 S.E.2d 378 (1971).

Trier of fact must be apprised of those who are going to share in the recovery in ascertaining the amount of damages recoverable under subdivision (b)(4) of this section, for it is only the losses suffered by these persons as a result of decedent's death which may be taken into account in assessing these damages. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Existence of Beneficiaries Not Condition Precedent. — The existence of persons who would have been entitled to the recovery under former G.S. 28-149 (now see G.S. 29-1 et seq.) was not a condition precedent to the right to bring the action. The purpose of the section is to give the action irrespective of who may become beneficiaries of the recovery. Warner v. Western N.C.R.R., 94 N.C. 250 (1886). See Davenport v. Patrick, 227 N.C. 686, 44 S.E.2d 203 (1947); McCoy v. Atlantic C.L.R.R., 229 N.C. 57, 47 S.E.2d 532 (1949), holding that evidence as to the number of children left is inadmissible.

Recovery, if negligence is proved, is by the decedent's personal representative and is not conditioned upon the decedent's leaving dependents or beneficiaries of his estate. Abernethy v. Utica Mut. Ins. Co., 373 F.2d 565 (4th Cir. 1967).

The right to sue granted by this statute is not conditioned upon who may be the ultimate beneficiary or beneficiaries of a recovery. Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832, cert. denied, 279 N.C. 726, 184 S.E.2d 883 (1971).

Complaint Need Not Allege That Intestate Left Heirs. — The damages when recovered are not to be simply distributed, but disposed of as provided in case of intestacy, and the complaint need not allege that the intestate left heirs. Warner v. Western N.C.R.R., 94 N.C. 250 (1886).

Children as Beneficiaries. — The fortuitous circumstance that those entitled to the recovery under the Intestate Succession Act happened to be the children rather than collateral kin of the decedent is not germane to the administrator's right of action. Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832, cert. denied, 279 N.C. 726, 184 S.E.2d 883 (1971).

Evidence of the decedent's dependents or beneficiaries is irrelevant and inadmissible. Abernethy v. Utica Mut. Ins. Co., 373 F.2d 565 (4th Cir. 1967).

Certain liability is imposed for death, and that liability is exclusive. No other responsibility is left which springs from the occurrence upon which liability rests — death — and the effect of the compensation as a satisfaction of all other claims is in no way limited or impaired by the circumstances of the identity of the persons to whom it is paid or because in a given case no one survives to take advantage of the statute. Horney v. Meredith Swimming Pool Co., 267 N.C. 521, 148 S.E.2d 554 (1966).

When Rights of Distributees Fixed. — Under this section the rights of the distributees are fixed as of the time when the intestate died. Neill v. Wilson, 146 N.C. 242, 59 S.E. 674 (1907). See Davenport v. Patrick, 227 N.C. 686, 44 S.E.2d 203 (1947).

Two Rights of Action Recognized. — The right of an injured person to sue for personal injuries of any kind is entirely separate and distinct from the right of the personal representative to sue under authority of the wrongful death statute. Any damage sustained by such person during his lifetime is personal to that person and, if proximately caused by the wrongful act of another, could be recovered by him. If this right of action survived his death, the recovery would be an asset of his estate to be administered as any other personal property owned and possessed by decedent at the time of his death. Hoke v. Atlantic Greyhound Corp., 226 N.C. 332, 38 S.E.2d 105 (1946).

While both the right of action for the recovery of consequential damages sustained between date of injury and date of death, and the right of action to recover damages resulting from such death, have as basis the same wrongful act, there is no overlapping of amounts recoverable. But such consequential damages as flow from the wrongful act would be recoverable by the personal representative; those sustained by the injured party during his lifetime, for benefit of his estate, and those resulting from his death, for benefit of his next of kin, determinable upon separate issues. Hoke v. Atlantic Greyhound Corp., 226 N.C. 332, 38 S.E.2d 105 (1946).

Distribution of Federal Action Proceeds. — The proceeds from a federal court action instituted by the decedent's personal representative were for damages related to his wrongful death, not damages for pain and suffering unrelated to his death, and therefore should have been distributed according to the laws of intestate succession; although the funds were not characterized as wrongful death benefits in the settlement agreement, the federal court record supported such a characterization. In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Creditor Has No Claim against Wrongful Death Funds. — Where the funds obtained by compromise settlement are for damages recoverable for death by wrongful act, the plaintiff creditor has no enforceable claim against these funds or any portion of them. Forsyth County v. Barneycastle, 18 N.C. App. 513, 197 S.E.2d 576, cert. denied, 283 N.C. 752, 198 S.E.2d 722 (1973).

Recovery Not Assets of Deceased's Estate. — Damages for a wrongful death are not assets of the estate available to creditors, but are to be disposed of according to the statute of distribution. Hines v. Foundation Co., 196 N.C. 322, 145 S.E. 612 (1928).

Proceeds recovered in a wrongful death action do not constitute part of the estate of the deceased generally except for certain limited purposes. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

The provision that the recovery is not to be applied as assets in the payment of debts or legacies extends to creditors of the intestate and not to creditors of the distributees. Neill v. Wilson, 146 N.C. 242, 59 S.E. 674 (1907).

The right of action for wrongful death, being conferred by statute at death, never belonged to the deceased, and the recovery is not assets in the usual acceptation of the term. Lamm v. Lorbacher, 235 N.C. 728, 71 S.E.2d 49 (1952); In re Ives' Estate, 248 N.C. 176, 102 S.E.2d 807 (1958).

Proceeds recovered under the wrongful death statute are not a part of a decedent's estate, and in dealing with these funds neither the clerk nor the estate's personal representative is administering the estate of a decedent. In re Estate of Below, 12 N.C. App. 657, 184 S.E.2d 378 (1971).

The amount recovered is not a general asset of the estate, but the personal representative shall dispose of it as provided in this section and the Intestate Succession Act. Long v. Coble, 11 N.C. App. 624, 182 S.E.2d 234, cert. denied, 279 N.C. 395, 183 S.E.2d 246 (1971).

The recovery in an action for wrongful death created by and based on this section is not a general asset of the decedent's estate. It is not subject to the payment of his debt, nor could the decedent by will or otherwise have diverted any portion of such recovery from the persons who would be entitled thereto under the Intestate Succession Act. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

But Treated as Assets for Medical and Burial Expenses. — A cause of action for wrongful death, being conferred by statute at death, could never have belonged to the deceased. A recovery resulting from such cause of action is therefore not an asset of the deceased's estate, although by virtue of the specific provisions of this section it is treated as an asset with respect to burial expenses and certain hospital and medical costs. In re Estate of Below, 12 N.C. App. 657, 184 S.E.2d 378 (1971).

Amounts received in a wrongful death action are assets at least to the extent of funeral and limited medical expenses. Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984).

Formerly, Payment of Hospital and Medical Expenses Was Unauthorized. — See In re Peacock, 261 N.C. 749, 136 S.E.2d 91 (1964).

Now Such Payment Is Limited by This Section. — See In re Peacock, 261 N.C. 749, 136 S.E.2d 91 (1964).

Not Subject to Widow's Year's Support. — See Broadnax v. Broadnax, 160 N.C. 432, 76 S.E. 216 (1912).

Contributory Negligence of One Beneficiary. — In an action to recover for wrongful death of a 21/2-year-old child, contributory negligence on the part of its mother is a bar to so much of the recovery as would accrue to her as a beneficiary of the child's estate, but negligence of the child's mother will not be imputed to the child's father, and is no bar to the recovery of the amount which would inure to his benefit as beneficiary of the child's estate. Pearson v. National Manufacture & Stores Corp., 219 N.C. 717, 14 S.E.2d 811 (1941).

Statutory Beneficiary Not Entitled to Share in Recovery for Death Caused by His Negligence. — In cases instituted to recover damages for wrongful death, no beneficiary under the statute for whom recovery is sought will be permitted to enrich himself by his own wrong. The right of a person otherwise entitled to receive the money paid for wrongful death, or to share in the distribution of such a sum paid, will be denied where the death of the decedent was caused by such person's negligence. In re Ives' Estate, 248 N.C. 176, 102 S.E.2d 807 (1958).

The court will look beyond the parties to the suit and prevent a beneficiary from obtaining any sum by way of recovery in a death by wrongful act where his own wrong had brought about the death. Miller v. Perry, 307 F. Supp. 633 (E.D.N.C. 1969), rev'd on other grounds, 456 F.2d 63 (4th Cir. 1972).

Where it is a husband's wrongful act which caused the death of his wife intestate, he may not share in a recovery. Should the jury return a verdict in favor of the administrator of her estate, the court will enter judgment for only two thirds of the amount of the verdict. Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832, cert. denied, 279 N.C. 726, 184 S.E.2d 883 (1971).

In an action by an administrator under the Wrongful Death Act, where a husband caused the death of his wife, the award must be reduced by the statutory share of the wrongdoer. St. Paul Fire & Marine Ins. Co. v. Lack, 476 F.2d 583 (4th Cir. 1973).

Intestate was killed in a collision while riding as a passenger in an automobile owned and driven by her son. Intestate's administrator and the son's insurer effected a settlement whereby the insurer paid the administrator a sum of money in consideration of the release by the administrator of all claims and demands against the son and the insurer arising out of the accident. There was no finding of fact that the son was negligent, or that he knew of the settlement, and the release stated that all parties released denied liability; however, the son, although he alleged in his answer that he was not negligent and that the accident was caused solely by the negligence of the driver of the other automobile did not allege that he had brought suit or made any claim or demand against such driver for damage to his automobile, and offered no evidence at the hearing. It was held that public policy would not permit the son to share in the amount paid in settlement by his insurer. In re Ives' Estate, 248 N.C.

176, 102 S.E.2d 807 (1958).

This result is not precluded by the "slayer statute," G.S. 31A-4, which excludes the wrongdoer from taking by declaring him to have constructively died prior to the deceased, since the slayer's exclusion by G.S. 31A-4 appears to apply only to inheritance from the decedent's "estate," while wrongful death awards have consistently been deemed not to pass through the personal estate of the deceased, but rather to arise out of a right of action belonging peculiarly to the personal representative for the benefit of the intestate successors. St. Paul Fire & Marine Ins. Co. v. Lack, 476 F.2d 583 (4th Cir. 1973).

Recovery Reduced by Liable Beneficiary's Share. — In wrongful death actions where recovery depends on establishing the liability of a party who is also a beneficiary of the decedent's estate, any recovery obtained shall be reduced by that party-beneficiary's pro rata share, and that party-beneficiary is precluded from participating in the recovery; but the action may be maintained on behalf of the other beneficiaries, if any. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Effect of Liability of Sole Beneficiary. — If recovery in a wrongful death action depends upon establishing the liability of a party who is the sole beneficiary of the decedent's estate, the action may not be maintained at all. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Nonnegligent Parent Allowed to Recover for Child's Death. — A wrongful death action could be maintained on behalf of deceased child's estate against defendant mother, but only father would be entitled to share in any recovery, since any recovery obtained would be grounded on the negligence of the mother. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Family Purpose Doctrine Did Not Bar Husband's Recovery Where Wife Negligent. — Husband was not barred by the family purpose doctrine from sharing in any recovery by his son's estate because of the negligence of his wife, the defendant in driving the husband's automobile. Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984).

Plaintiff father, having abandoned the deceased when the latter was a minor child, could not share in the proceeds of the settlement of the claim for wrongful death now in the hands of the administratrix. Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

Distribution When Deceased Was Nonresident. — Where a person was domiciled in another state and was killed in this State, and an administrator sues in this State, the funds recovered must be distributed under the laws of this State, though a prior administration had been taken out in the state of his domicile. Hartness v. Pharr, 133 N.C. 566, 45 S.E. 901 (1903). See Hall v. Southern R.R., 146 N.C. 345, 59 S.E. 879 (1907).

Allocation of Funds Received in Single Settlement for Wrongful Death and for Suffering Prior to Death. — See In re Peacock, 261 N.C. 749, 136 S.E.2d 91 (1964).

Recovery under Federal Employers' Liability Act. — In an action to recover damages under the Federal Employers' Liability Act, this State statute does not apply as to the distribution of the recovery. Horton v. Seaboard Air Line Ry., 175 N.C. 472, 95 S.E. 883 (1918), appeal dismissed, 251 U.S. 566, 40 S. Ct. 180, 64 L. Ed. 417 (1920).

Attorneys' Fees. — The 1985 amendment to this section provides that an attorney who litigates a wrongful death claim may be paid for his services from the wrongful death proceeds. In re Lessard, 78 N.C. App. 196, 336 S.E.2d 712 (1985).

Attorney who neither initiated nor handled wrongful death claim and was appointed successor administrator only after wrongful death award had been made, but who expended considerable time in determining the correct distribution of wrongful death proceeds, could be compensated for his services from the wrongful death proceeds. In re Lessard, 78 N.C. App. 196, 336 S.E.2d 712 (1985).

"Costs" of an estate would not be payable from wrongful death proceeds. In re Lessard, 78 N.C. App. 196, 336 S.E.2d 712 (1985).

V. DAMAGES RECOVERABLE.

A. In General.

Purpose of damages in a wrongful death case is to restore the beneficiaries to the position they would have occupied had there been no death. Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, cert. denied, 306 N.C. 744, 295 S.E.2d 480 (1982).

Legislature Intended to Be as Full Compensation as Possible. — The General Assembly intended the wrongful death statute to as fully as possible compensate persons for the loss of their decedent. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Basis for Damages Generally. — In this State the recovery in a wrongful death case is based largely on losses suffered by particular beneficiaries. Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, cert. denied, 306 N.C. 744, 295 S.E.2d 480 (1982).

This section allows the personal representative, on behalf of the statutory beneficiaries of the estate, to recover, inter alia, the present monetary value of the decedent to the beneficiaries. The measure is the worth of the decedent; how well off the beneficiaries are absent the decedent is immaterial. Harris v. United States, 121 F.R.D. 652 (W.D.N.C. 1988).

This section controls the measure of damages. Nelson v. United States, 541 F. Supp. 816 (M.D.N.C. 1982).

The action for wrongful death exists only by virtue of this section, and the statutory provision must govern not only the right of action but also the rule for determining the basis and extent of recovery of damages therefor. Lamm v. Lorbacher, 235 N.C. 728, 71 S.E.2d 49 (1952).

In North Carolina a right of action to recover damages for wrongful death is given by this section and in this jurisdiction the action for wrongful death exists only by virtue of these statutes. In re Miles' Estate, 262 N.C. 647, 138 S.E.2d 487 (1964).

Wrongful death damages are unlimited. Brendle v. General Tire & Rubber Co., 408 F.2d 116 (4th Cir. 1969).

Determination of Damages Recoverable under Subsection (b). — Damages recoverable under subsection (b) are not determined by ascertaining the net pecuniary loss suffered by the estate, but are determined by ascertaining the present monetary loss suffered by those persons entitled to receive the damages. Bowen v. Constructors Equip. Rental Co., 16 N.C. App. 70, 191 S.E.2d 419 (1972), aff'd, 283 N.C. 395, 196 S.E.2d 789 (1973).

Where the measure of damages in death cases is "loss to beneficiaries," rather than the "loss to estate," a beneficiary's right to recover the value of expected benefits is limited to his life expectancy. Bowen v. Constructors Equip. Rental Co., 16 N.C. App. 70, 191 S.E.2d 419 (1972), aff'd, 283 N.C. 395, 196 S.E.2d 789 (1973).

Question as to Economic Loss to Estate Not Error. — Where plaintiff's lawyer asked doctor "Do you have an opinion as to the present value of the economic loss to the estate?", defendant was correct in pointing out that recovery of damages under the statute is to the beneficiaries of the decedent and not to the decedent's estate; however, it was plain from the record that both doctor and the jury understood the correct measurement of damages under the wrongful death statute. Stutts v. Adair, 94 N.C. App. 227, 380 S.E.2d 411 (1989).

As to measure of damages under former statute, see Kesler v. Smith, 66 N.C. 154 (1872); Burton v. Wilmington & W.R.R., 82 N.C. 504 (1880), modified on rehearing, 84 N.C. 192 (1881); Bradley v. Ohio River & C.R.R., 122 N.C. 972, 30 S.E. 8 (1898); Russell v. Windsor Steamboat Co., 126 N.C. 961, 36 S.E. 191 (1900); Carter v. North Carolina R.R., 139 N.C. 499, 52 S.E. 642 (1905); Poe v. Raleigh & A. Air Line R.R., 141 N.C. 525, 54 S.E. 406 (1906); Purnell v. Rockingham R.R., 190 N.C. 573, 130 S.E. 313 (1925); Carpenter v. Asheville Power & Light Co., 191 N.C. 130, 131 S.E. 400 (1926); Hicks v. Love, 201 N.C. 773, 161 S.E. 394 (1931); Queen City Coach Co. v. Lee, 218 N.C. 320, 11 S.E.2d 341 (1940); Rea v. Simowitz, 226 N.C. 379, 38 S.E.2d 194 (1946); McCoy v. Atlantic C.L.R.R., 229 N.C. 57, 47 S.E.2d 532 (1948); Hanks v. Norfolk & W.R.R., 230 N.C. 179, 52 S.E.2d 717 (1949); Martin v. Currie, 230 N.C. 511, 53 S.E.2d 447 (1949); United States v. Brooks, 176 F.2d 482 (4th Cir. 1949); Journigan v. Little River Ice Co., 233 N.C. 180, 63 S.E.2d 183 (1951); Lamm v. Lorbacher, 235 N.C. 728, 71 S.E.2d 49 (1952); Caudle v. Southern Ry., 242 N.C. 466, 88 S.E.2d 138 (1955); Bryant v. Woodlief, 252 N.C. 488, 114 S.E.2d 241 (1960); Scriven v. McDonald, 264 N.C. 727, 142 S.E.2d 585 (1965); Smith v. Mercer, 276 N.C. 329, 172 S.E.2d 489 (1970); Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973); Mosley v. United States, 538 F.2d 555 (4th Cir. 1976).

Recovery to Be One Compensation in Lump Sum. — This section contemplates that if plaintiff be entitled to recover at all, he is entitled to recover as damages one compensation in a lump sum. He is not entitled to recover the whole sum from each of the joint tortfeasors. Kendrick v. Cain, 272 N.C. 719, 159 S.E.2d 33 (1968).

Damages may not be assessed on the basis of sheer speculation, devoid of factual substantiation. Gay v. Thompson, 266 N.C. 394, 146 S.E.2d 425 (1966); Stetson v. Easterling, 274 N.C. 152, 161 S.E.2d 531 (1968).

But Some Speculation Is Necessary to Determine Damages. — In allowing recovery under this section, this State's courts have recognized that, by necessity, some speculation is necessary in determining damages. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

And Jury May Base Speculation on Facts. — Damages in any wrongful death action are to some extent uncertain and speculative. A jury may indulge in speculation in assessing damages where it is necessary and there are sufficient facts to support speculation. Gay v. Thompson, 266 N.C. 394, 146 S.E.2d 425 (1966); Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Some Speculation Not Grounds for Refusing All Damages. — The fact that the full extent of the damages must be a matter of some speculation is not ground for refusing all damages. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975); Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Nor Is Absence of Yardstick for Ascertaining Monetary Recovery. — Monetary recovery cannot be denied simply because no yardstick for ascertaining the amount thereof has been provided. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Negative Factors Held Relevant to Present Monetary Value. — Evidence regarding 19 year old decedent's low level of educational attainment, absence of regular employment, status of dependency on her parents, and history of alcohol and drug abuse was clearly relevant to a determination of her "present monetary value ... to the persons entitled to receive the damages recovered," and the jury could conclude that these negative factors offset, to the extent found, what decedent's present monetary value would have been in their absence. Pearce v. Fletcher, 74 N.C. App. 543, 328 S.E.2d 889 (1985), upholding award of damages in the amount of $5,000.

Under Subsection (b)(4), only reasonably expected net income of decedent can be recovered. Victim's parents, his only survivors, could only recover the amount of his income that they reasonably might have received had he lived. State v. Smith, 90 N.C. App. 161, 368 S.E.2d 33 (1988), aff'd, 323 N.C. 703, 374 S.E.2d 866, cert. denied, 490 U.S. 1100, 109 S. Ct. 2453, 104 L. Ed. 2d 1007 (1989).

Trial Court Erred in Application of This Section. — Although the trial court properly used the wrongful death statute to compute the amount of restitution which defendant found guilty of misdemeanor death by vehicle should pay, it erred in its application of this section. State v. Smith, 90 N.C. App. 161, 368 S.E.2d 33 (1988), aff'd, 323 N.C. 703, 374 S.E.2d 866, cert. denied, 490 U.S. 1100, 109 S. Ct. 2453, 104 L. Ed. 2d 1007 (1989).

Certain increased medical expenses as well as funeral bills incident to the death of a 40 week-old fetus could only be recovered by the administrator of the fetal estate pursuant to an action under this section. Johnson v. Ruark Obstetrics & Gynecology Assocs., 89 N.C. App. 154, 365 S.E.2d 909 (1988), aff'd, 327 N.C. 283, 395 S.E.2d 85 (1990), rehearing denied, 327 N.C. 644, 399 S.E.2d 133 (1990).

Injured Person's Right of Action to Recover Damages Survives. — An injured person's common-law right of action in respect of damages he sustained during the interval between injury and death now survives to his personal representative. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Damages Sustained by Deceased in His Lifetime Recoverable under Former Statute. — See Hoke v. Atlantic Greyhound Corp., 226 N.C. 332, 38 S.E.2d 105 (1946).

Liability of Damages for Payment of Decedent's Debts. — It seems improbable that the General Assembly intended that recovery for items of damage within subsection (b)(1), (2) and (5) should be exempt from liability for the payment of the debts and legacies of the decedent. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

The value of the life before 21 as well as after 21 years of age was recoverable. Gurley v. Southern Power Co., 172 N.C. 690, 90 S.E. 943 (1916).

Wrongful Death of Child. — The meaning of damages, in the case of the wrongful death of a child is the same as in the case of an adult. The difficulty is in the application. Russell v. Windsor Steamboat Co., 126 N.C. 961, 36 S.E. 191 (1900). See Gurley v. Southern Power Co., 172 N.C. 690, 90 S.E. 943 (1916); Scriven v. McDonald, 264 N.C. 727, 142 S.E.2d 585 (1965).

The measure of damages for the death of a child is the same as for an adult, notwithstanding the difficulty of applying the rule is greatly increased in the case of an infant. Burton v. Croghan, 265 N.C. 392, 144 S.E.2d 147 (1965).

Hedonic damages are not recoverable under subdivision (b) of this section. Livingston v. United States, 817 F. Supp. 601 (E.D.N.C. 1993).

Burden of Proof under Former Statute. — See Scriven v. McDonald, 264 N.C. 727, 142 S.E.2d 585 (1965); Greene v. Nichols, 274 N.C. 18, 161 S.E.2d 521 (1968); Maynor v. Townsend, 2 N.C. App. 19, 162 S.E.2d 677 (1968); Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Instructions as to Life Expectancy of Persons Entitled to Recovery. — Where there is evidence tending to show that persons entitled to receive the damages recovered have a shorter life expectancy than that of deceased, it is error for the court to fail to instruct the jury to consider the life expectancy of such persons in determining the amount of damages recoverable. Bowen v. Constructors Equip. Rental Co., 16 N.C. App. 70, 191 S.E.2d 419 (1972), aff'd, 283 N.C. 395, 196 S.E.2d 789 (1973).

Argument that defendant would be obligated to pay every single dollar of the damage award might be interpreted by the jury as meaning that defendant was not protected by automobile liability insurance, and such argument was unfair to the plaintiff and improper. Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, cert. denied, 306 N.C. 744, 295 S.E.2d 480 (1982).

Instruction That Damages Are Tax Exempt Is Erroneous. — It is reversible error for the trial court to instruct the jury that damages awarded in a wrongful death action are exempt from federal and state income taxes. Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, cert. denied, 306 N.C. 744, 295 S.E.2d 480 (1982).

And Inequitable. — It would be inequitable to give an income tax exemption instruction to the jury without allowing evidence relative to the effect that the exemption would have on the future tax liability of each of the particular beneficiaries, which would unduly complicate a wrongful death action, which is already complicated by statute. Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, cert. denied, 306 N.C. 744, 295 S.E.2d 480 (1982).

Question of Damages Is for Jury. — See Carter v. North Carolina R.R., 139 N.C. 499, 52 S.E. 642 (1905); Horton v. Seaboard Air Line R.R., 175 N.C. 472, 95 S.E. 883 (1918), appeal dismissed, 251 U.S. 566, 40 S. Ct. 180, 64 L. Ed. 417 (1920); Carpenter v. Asheville Power & Light Co., 191 N.C. 130, 131 S.E. 400 (1926).

The assessment of damages must, to a large extent, be left to the good sense and fair judgment of the jury. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

The assessment of damages must, to a large extent, be left to the good sense and fair judgment of the jury — subject, of course, to the discretionary power of the judge to set its verdict aside when, in his opinion, equity and justice so require. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

The jurors being "the sole judges of the facts" are necessarily the sole judges of whether they are "satisfied from the evidence and by its greater weight" that plaintiff sustained damages and, if so, whether there is evidence from which they can reasonably determine the approximate amount of the plaintiff's pecuniary loss. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Trial Court Should Submit to Jury Separate Issues for Compensatory and Punitive Damages. — In wrongful death action, trial court should submit to jury separate issues for compensatory and punitive damages when evidence supports submission of these issues. Jones v. McCaskill, 99 N.C. App. 764, 394 S.E.2d 254 (1990).

Double Recovery Not Permitted. — Because recovery for any diminishment in the quality of life of the survivors in a wrongful death case is already addressed in effect under subdivisions (b)(4)b and (b)(4)c, allowance of separate hedonic damages would result in double recovery. Livingston v. United States, 817 F. Supp. 601 (E.D.N.C. 1993).

Relevant Evidence. — Evidence pertaining to disease of plaintiff's decedent and the effect it had on his relationship with his parents had a tendency to prove the extent of damages, which were in controversy in wrongful death action. The evidence was therefore relevant and should have been admitted on that ground. Hales v. Thompson, 111 N.C. App. 350, 432 S.E.2d 388 (1993).

B. Pain and Suffering.

There is a surviving cause of action for predeath expenses and pain and suffering. Brendle v. General Tire & Rubber Co., 408 F.2d 116 (4th Cir. 1969).

However, Decedent Must Have Been Conscious. — In an action under the Federal Tort Claims Act arising out of a vehicular accident, the extent of the accident inflicted massive head injuries making it improbable that the decedent was conscious following the collision, and therefore ruling out recovery for post-accident pain and suffering. Livingston v. United States, 817 F. Supp. 601 (E.D.N.C. 1993).

Recovery for Pain and Suffering and for Medical Expenses. — Recovery for pain and suffering and for hospital and medical expenses relate to a single cause of action and should be submitted upon a single issue of damages. Hoke v. Atlantic Greyhound Corp., 226 N.C. 332, 38 S.E.2d 105 (1946); In re Peacock, 261 N.C. 749, 136 S.E.2d 91 (1964).

Damages for the pain and suffering of a decedent fetus are recoverable if they can be reasonably established. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987).

C. Burial Expenses.

Recovery of Burial Expenses. — A cause of action does not exist for the recovery of burial expenses in an action for wrongful death separate and apart from the right to recover for the wrongful death. The statute provides for the payment of burial expenses out of "the amount recovered in such action." Davenport v. Patrick, 227 N.C. 686, 44 S.E.2d 203 (1947); Crawford v. Hudson, 3 N.C. App. 555, 165 S.E.2d 557 (1969), overruled on other grounds, Gibson v. Campbell, 28 N.C. App. 653, 222 S.E.2d 449 (1976).

Prenatal Death of Viable Child. — Medical and funeral expenses, as well as punitive and nominal damages, should be allowed in the case of a decedent fetus where appropriate. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987).

D. Loss of Decedent's Income, Services, Society, etc.

The paragraphs of subdivision (b)(4) enumerate some of the factors to be considered in determining the present monetary value of the decedent to the persons entitled to the damages recovered. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Damages determinable in accordance with subdivision (b)(4) are quite different from damages determinable on the basis of the pecuniary injury suffered by the decedent's estate as the result of his death. Smith v. Mercer, 276 N.C. 329, 172 S.E.2d 489 (1970); Bowen v. Constructors Equip. Rental Co., 16 N.C. App. 70, 191 S.E.2d 419 (1972), aff'd, 283 N.C. 395, 196 S.E.2d 789 (1973).

No rule is prescribed for the measurement or ascertainment of the damages recoverable under subdivision (b)(4). It would be difficult, if not impossible, to formulate a rule of general application for the measurement of such damages. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

The present monetary value of the decedent to the persons entitled to receive the damages recovered will usually defy any precise mathematical computation. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975); Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Damages for any items under subdivision (b)(4), unless the decedent was a person of established earning capacity beyond his or her personal needs, involve in large measure speculative and intangible considerations. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Since the persons entitled to the damages recovered may have suffered substantial losses on account of the items of damage under subdivision (b)(4), it cannot be said that there can be no recovery for these items of damages because no yardstick for ascertaining the amount thereof has been provided. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973).

Direct evidence of earnings is not essential, it being sufficient to present evidence of "health, age, industry, means and business." Maynor v. Townsend, 2 N.C. App. 19, 162 S.E.2d 677 (1968).

It is not essential that direct evidence of the earnings of a deceased adult be offered in order for there to be recovery of damages. Evidence of his health, age, industry, means and business are competent to show loss. Reeves v. Hill, 272 N.C. 352, 158 S.E.2d 529 (1968).

Although it is not essential that direct, specific evidence be offered with reference to decedent's earning capacity, it is required that plaintiff offer some evidence tending to show that intestate was potentially capable of earning money in excess of that which would be required for her support. Greene v. Nichols, 274 N.C. 18, 161 S.E.2d 521 (1968).

But Direct Evidence of Intent to Give Is Essential. — The trial judge erred in submitting to the jury as an element of damages the amount of income plaintiffs could reasonably have expected from the deceased where the plaintiffs presented no direct evidence that their deceased daughters "had ever expressed an intent to provide any of [their] income to [their] parents"; although the evidence indicated that deceased daughters were brought up in a family and culture within which intrafamily financial assistance was favored, absolutely no evidence tended to show that the two teenage girls, specifically, would grow up to follow this example. Bahl v. Talford, 138 N.C. App. 119, 530 S.E.2d 347, 2000 N.C. App. LEXIS 537 (2000).

Prenatal Death of Viable Child. — Lost income damages normally available under subdivision (b)(4)a cannot be recovered in an action for the wrongful death of a stillborn child. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987).

Damages normally recovered under subdivision (b)(4)b and c, for loss of services, companionship, advice and the like, will not be available in an action for the wrongful death of a viable fetus. DiDonato v. Wortman, 320 N.C. 423, 358 S.E.2d 489, rehearing denied, 320 N.C. 799, 361 S.E.2d 73 (1987).

Loss of bloodline and denial of grandchildren are not grounds for recovery under this section. Livingston v. United States, 817 F. Supp. 601 (E.D.N.C. 1993).

Evidence of Earnings in Excess of Amount Needed to Support Decedent Required. — It is required that plaintiff offer some evidence tending to show that intestate was potentially capable of earning money in excess of that which would be required for her support. Maynor v. Townsend, 2 N.C. App. 19, 162 S.E.2d 677 (1968).

Showing of Actual Support of Parents Not Required. — Trial judge did not err by instructing the jury that it could award damages to decedent's parents for the loss of her net income; there is no reason to demand actual support of the parents as the sole ground for any recovery of lost income since such a requirement would run counter to the remedial purpose of the statute and to the evidentiary provisions of subsection (c). Stutts v. Adair, 94 N.C. App. 227, 380 S.E.2d 411 (1989).

Estimating Life Expectancy of Child. — In an action for the wrongful death of a child nine years of age the rule for measuring damages is that expectancy of life may be determined by the jury based upon the constitution, health and habits of the infant, and where the jury was so instructed, it was not error for the court in illustrating the rule to use the figures 50 and 20 in referring to life expectancy. Rea v. Simowitz, 226 N.C. 379, 38 S.E.2d 194 (1946).

Expert Testimony as to Monetary Value of Decedent. — An expert economist's testimony in a wrongful death action as to the present monetary value of the decedent to the persons entitled to receive damages under subsection (b) was properly admitted in evidence without the witness first having placed into evidence the statistics, formulae, calculations and economic assumptions used in arriving at his opinion. While the failure to elaborate on the witness' computations might have weakened the probative value of the testimony, it did not affect its admissibility. Rutherford v. Bass Air Conditioning Co., 38 N.C. App. 630, 248 S.E.2d 887 (1978), cert. denied, 296 N.C. 586, 254 S.E.2d 34 (1979).

The testimony of an expert who predicted economic loss based on available knowledge pertaining to decedent, including testimony of his work supervisors and testimony regarding the decedent's skills and wage data, as well as expert's own expertise and ability to project a person's likely economic status through the use of data available in his field provided a reasonable basis for the computation of damages, even though the result was, at best, only approximate. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Expert testimony is practically the only evidence available to prove future earnings in a wrongful death action. Thorpe v. Wilson, 58 N.C. App. 292, 293 S.E.2d 675 (1982).

When Judge Must Set Verdict Aside. — In awarding damages for wrongful death the jury is not ordinarily required as a matter of law to award damages for all or any of the items specified in paragraphs a, b, and c of subdivision (b)(4). It is only when the jury has arbitrarily disregarded the law and the evidence that the judge must exercise his judicial discretion and set the verdict aside. Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Damages for Lost Future Wages Not Allowed for Fisherman. — Self-employed commercial fisherman was a "person otherwise engaged in maritime trade" and thus was prevented from recovering nonpecuniary damages or damages for lost future earnings. In re Goose Creek Trawlers, Inc., 972 F. Supp. 946 (E.D.N.C. 1997).

No evidence was offered showing that the decedent, who died of accidental strangulation in a nursing home, was potentially capable of earning money in excess of that which would be required for her support, and the jury's award as to these damages, therefore, would necessarily be based on speculation and not supported by evidence; consequently, the trial court erred in instructing the jury that it could award damages for loss of the decedent's net income, pursuant to G.S. § 28A-18-2(b)(4), which required a new trial as to the issue of damages for the decedent's wrongful death. Estate of Hendrickson v. Genesis Health Venture, Inc., 151 N.C. App. 139, 565 S.E.2d 254, 2002 N.C. App. LEXIS 722 (2002), cert. denied, 356 N.C. 299, 570 S.E.2d 503 (2002).

E. Punitive Damages.

Three Categories of Conduct Affording Recovery. — By providing for recovery of punitive damages upon a showing of "maliciousness, wilful or wanton injury, or gross negligence" it appears that the General Assembly intended to establish three separate categories of conduct which would afford a recovery. Cole v. Duke Power Co., 81 N.C. App. 213, 344 S.E.2d 130, cert. denied, 318 N.C. 281, 347 S.E.2d 462 (1986).

Recovery for Gross Negligence Even Absent Wilful or Wanton Conduct. — This section allows recovery of punitive damages in wrongful death actions involving gross negligence even when no wilful or wanton conduct was involved. To establish gross negligence, the plaintiff must show negligence of an aggravated character. Henderson v. LeBauer, 101 N.C. App. 255, 399 S.E.2d 142 (1991).

Gross Negligence Authorizes Punitive Damages. — Although the term "gross negligence" is not defined in this section, based on prior case law the inclusion of gross negligence would authorize punitive damages in cases where the defendant's conduct was something less than willful or wanton. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

This section specifically allows the award of punitive damages upon a showing of gross negligence. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982); Cole v. Duke Power Co., 81 N.C. App. 213, 344 S.E.2d 130, cert. denied, Sedberry v. Johnson, 62 N.C. App. 425, 302 S.E.2d 924 (1983).

"Gross negligence" does not constitute a lower standard of negligence than "willful or wanton conduct" in the context of a wrongful death suit. Benton v. Hillcrest Foods, Inc., 136 N.C. App. 42, 524S.E.2d 53, 1999 N.C. App. LEXIS 1296 (1999).

Punitive Damages Not Recoverable from Wrongdoer's Personal Representative. — The general rule is that there can be no recovery for punitive damages against the personal representative of the deceased wrongdoer, however aggravated the circumstances may be. The sole purpose of the allowance of punitive damages is to punish the wrongdoer. The death of the wrongdoer precludes his being punished by the assessment of punitive damages. Thorpe v. Wilson, 58 N.C. App. 292, 293 S.E.2d 675 (1982).

Punitive damages are recoverable from municipalities in wrongful death cases on the same basis as from other tort-feasors. Jackson v. Housing Auth., 73 N.C. App. 363, 326 S.E.2d 295 (1985), aff'd, 316 N.C. 259, 341 S.E.2d 523 (1986).

Reading portions of G.S. 12-3(6) into this section, the North Carolina Wrongful Death Act contains a statutory provision providing for the recovery of punitive damages from bodies politic, which includes municipal corporations. Jackson v. Housing Auth., 316 N.C. 259, 341 S.E.2d 523 (1986).

Recovery from Municipal Corporations. — This section, the North Carolina Wrongful Death Act, contains a statutory provision providing for the recovery of punitive damages from bodies politic, which includes municipal corporations. Jackson v. Housing Auth., 316 N.C. 259, 341 S.E.2d 523 (1986).

Evidence Meriting Submission of Punitive Damages. — In wrongful death case, plaintiff's evidence which tended to show numerous violations of the National Electric Safety Code and of defendant power company's own standards was sufficient to merit the submission of the issue of punitive damages to the jury. Beck v. Carolina Power & Light Co., 57 N.C. App. 373, 291 S.E.2d 897, aff'd, 307 N.C. 267, 297 S.E.2d 397 (1982).

Punitive Damages Unwarranted in the Absence of Wilful and Wanton Conduct. — Wife of a decedent who was electrocuted on a stairwell at an amphitheater, which was operated by a subsidiary, could not recover punitive damages under G.S. 1D-5(7), 1D-15(c), and 28A-18-2 because evidence showing: (1) that the subsidiary had been informed prior to the accident that other patrons had been electrocuted on a stairwell; and (2) that the subsidiary took ineffective efforts to address electrical hazards did not demonstrate a wilful and wanton disregard for the safety of others. Faris v. Clear Channel Communs., Inc., — F. Supp. 2d —, 2006 U.S. Dist. LEXIS 63059 (W.D.N.C. Sept. 1, 2006).

When Directed Verdict Proper as to Claim for Punitive Damages. — In a wrongful death action arising out of negligence, a directed verdict may properly be granted against a plaintiff seeking punitive damages only where the evidence is insufficient as a matter of law to support a jury finding that the defendant wrongfully caused the death of the decedent in a malicious, wilful, wanton or grossly negligent manner. Boyd v. L.G. DeWitt Trucking Co., 103 N.C. App. 396, 405 S.E.2d 914, cert. denied, 330 N.C. 193, 412 S.E.2d 53 (1991).

Evidence Sufficient to Support Award of Punitive Damages. — Evidence of truck driver's driving record was sufficient for jury to find that trucker was an unsafe driver, that company for which he worked either knew or should have known of his danger to the rest of the driving public, and given the number and severity of his offense, was equally sufficient to support the jury's finding that company's negligent entrustment was wilful or wanton, so as to justify denial of defendants' motions for a directed verdict and for judgment notwithstanding the verdict on plaintiff's claim for punitive damages arising out of company's negligent entrustment. Boyd v. L.G. DeWitt Trucking Co., 103 N.C. App. 396, 405 S.E.2d 914, cert. denied, 330 N.C. 193, 412 S.E.2d 53 (1991).

Personal Representative's Claim Not Barred for Failure to Join with Parents. — Administratrix's claim for punitive damages for death of stillborn child was not barred merely because it was not joined with the settled claim of the parents; if defendants wished to allege that part of the moneys the parents received in settlement of their claims was for punitive damages, defendants would have a right to support that contention with evidence and have the jury consider it in evaluating the administratrix's claim for punitive damages. Greer v. Parsons, 103 N.C. App. 463, 405 S.E.2d 921, aff'd, 331 N.C. 368, 416 S.E.2d 174 (1992).

F. Nominal Damages.

Applicable Where No Pecuniary Loss Suffered. — Subdivision (b)(6) supplies a statutory basis which was lacking when previous cases were decided. Nominal damages and costs may now be recovered if the jury finds that the decedent's death was caused by the defendant's wrongful act but fails to find that such death caused pecuniary loss. Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973); Lentz v. Gardin, 30 N.C. App. 379, 226 S.E.2d 839, remanded on other grounds, 294 N.C. 425, 241 S.E.2d 508 (1978).

Jury Not Required to Award Damages. — A jury will not be required to award damages when the evidence adduced does not establish to its satisfaction facts which will reasonably support an assessment. In such a situation, by subdivision (b)(6) the legislature authorized "nominal damages when the jury so finds." Brown v. Moore, 286 N.C. 664, 213 S.E.2d 342 (1975).

Nominal Damages Appropriate. — Where the jury found that plaintiff had been "damaged by the negligence of the defendant", that the plaintiff's intestate did not contribute to her own injuries, and that plaintiff established her cause of action for wrongful death, the trial court erred in refusing to enter an award of nominal damages. Porter v. Leneave, 119 N.C. App. 343, 458 S.E.2d 513 (1995).

VI. ADMISSION OF DYING DECLARATIONS.

This is a general statute changing the rule of evidence, in which no one has a vested interest and which the law-making power can extend, alter or repeal at will. Williams v. Randolph & C.R.R., 182 N.C. 267, 108 S.E. 915 (1921).

And this change is valid and constitutional. Tatham v. Andrews Mfg. Co., 180 N.C. 627, 105 S.E. 423 (1920).

What Declarations Permitted. — This

section permits in evidence declarations of the act of killing and circumstances immediately attendant on the act, which constitute a part of the res gestae, uttered when the declarant was in actual danger of death, and made in full apprehension thereof, and when the death accordingly ensued. Tatham v. Andrews Mfg. Co., 180 N.C. 627, 105 S.E. 423 (1920).

As in criminal actions for homicide, the dying declarations of one whose wrongful death has been caused, to be admissible upon the trial of an action to recover damages for his wrongful death, must have been voluntarily made while the declarant was in extremis or under a sense of impending death, and must be confined to the act of killing and the attendant circumstances forming a part of the res gestae. Dellinger v. Elliott Bldg. Co., 187 N.C. 845, 123 S.E. 78 (1924).

Preliminary Facts Must Be Shown. — The dying declarations of a deceased person for whose death an action has been brought under this section are competent as evidence, provided the preliminary facts are made to appear. Southwell v. Atlantic C.L.R.R., 189 N.C. 417, 127 S.E. 361 (1925).

Otherwise they are not admissible. Holmes v. Wharton, 194 N.C. 470, 140 S.E. 93 (1927).

Declarations Made Before Occurrence of Accident. — Where the declarant was fatally injured in an automobile accident, declarations made by him the night before and two days before undertaking the journey are not admissible as dying declarations. Gassaway v. Gassaway, 220 N.C. 694, 18 S.E.2d 120 (1942).

Testimony of Statement Held Inadmissible. — In a workers' compensation case, testimony of a statement by an officer shortly before his death from coronary occlusion that he "had had a time all the morning" arresting three men who resisted him, was incompetent as a dying declaration, not having been brought within the terms of this section. West v. North Carolina Dep't of Conservation & Dev., 229 N.C. 232, 49 S.E.2d 398 (1948).

§ 28A-18-3. To sue or defend in representative capacity.

All actions and proceedings brought by or against personal representatives or collectors upon any cause of action or right to which the estate of the decedent is the real party in interest, must be brought by or against them in their representative capacity. (1868-9, c. 113, s. 79; Code, s. 1507; Rev., s. 160; C.S., s. 164; 1973, c. 1329, s. 3.)

Cross References. — As to parties, see G.S. 1A-1, Rule 17. As to when heirs and devisees are necessary parties, see G.S. 28A-17-4.

Legal Periodicals. — For note on the Erie doctrine and Rule 15(c), see 16 Wake Forest L. Rev. 621 (1980).

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Right of Action for Wrongful Death Is Purely Statutory. — Because the right to an action for wrongful death rests entirely upon the Wrongful Death Act, it must be asserted in conformity therewith. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

Suit Must Be Brought by Personal Representative. — Under the Wrongful Death Act, G.S. 28A-18-2, the administrator of an intestate, or the executor of one who dies testate, may institute an action for wrongful death; and he does so as the representative of the estate. Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754, cert. denied, 307 N.C. 696, 301 S.E.2d 389 (1983).

Application to Administrator De Bonis Non. — The provisions of this section apply to suits brought by administrator de bonis non, as well as to original administrator, and are mandatory. There is no middle ground. Rogers v. Gooch, 87 N.C. 442 (1882).

This section is silent as to any distinction between a resident and a foreign personal representative. Franklin v. Standard Cellulose Prods., Inc., 261 N.C. 626, 135 S.E.2d 655 (1964).

There is no statutory authority for a foreign executor or administrator to come into State courts and prosecute or defend an action in his representative capacity. Cannon v. Cannon, 228 N.C. 211, 45 S.E.2d 34 (1947); Brauff v. Commissioner of Revenue, 251 N.C. 452, 111 S.E.2d 620 (1959).

Action Against Nonresident Motorist's Personal Representatives Is Authorized as Exception. — An action authorized by former G.S. 1-105, as amended in 1953 to allow service of process upon the executor or administrator of a nonresident motorist, is an exception to the general rule stated in Cannon v. Cannon, 228

N.C. 211, 45 S.E.2d 34 (1947); Franklin v. Standard Cellulose Prods., Inc., 261 N.C. 626, 135 S.E.2d 655 (1964).

Action to collect note payable to decedent and maturing before his death must be instituted by the representative of his estate in his representative capacity. Cannon v. Cannon, 228 N.C. 211, 45 S.E.2d 34 (1947).

Heirs have no right to be made parties to an action on an account against a personal representative, although they allege collusion between the plaintiff and the representative. Byrd v. Byrd, 117 N.C. 523, 23 S.E. 324 (1895).

Applied in Tinkham v. Hall, 47 N.C. App. 651, 267 S.E.2d 588 (1980).

Cited in Davis v. Piper Aircraft Corp., 615 F.2d 606 (4th Cir. 1980); In re Lessard, 78 N.C. App. 196, 336 S.E.2d 712 (1985).

§ 28A-18-4. Service on or appearance of one binds all.

In actions against personal representatives or collectors, they are all to be considered as one person, representing the decedent; and if the summons is served on one or more, but not all, the plaintiff may proceed against those served, and if he recovers, judgment may be entered against all. (1868-9, c. 113, s. 81; Code, s. 1508; Rev., s. 161; C.S., s. 165; 1973, c. 1329, s. 3.)

§ 28A-18-5. When creditors may sue on claim; execution in such action.

An action may be brought by a creditor against the personal representative or collector on a demand at any time after it is due, but no execution shall issue against the personal representative or collector on a judgment therein against him without leave of the court, upon notice of 20 days and upon proof that the defendant has refused to pay such judgment or its ratable part, and such judgment shall be a lien on the property of the estate of the decedent only from the time of such leave granted. (1868-9, c. 113, s. 82; Code, s. 1509; Rev., s. 162; C.S., s. 166; 1973, c. 1329, s. 3.)

Cross References. — For provision that suit does not create lien against representative, see G.S. 28A-19-17.

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Any Court May Entertain Suit to Establish Claim. — In construing this section, it was decided at a very early day after its enactment that any court having jurisdiction of the amount sued for could entertain the suit of the creditor so far as to establish his claim and give him judgment therefor. Heilig v. Foard, 64 N.C. 710 (1870); Vaughn v. Stephenson, 69 N.C. 212 (1873); Shields v. Payne, 80 N.C. 291 (1879); Hoover v. Berryhill, 84 N.C. 132 (1881).

Jurisdiction for Breach of Contract. — The superior court in term has, under this section, jurisdiction of an action by a creditor against an administrator for breach of a contract made by his interstate. Shields v. Payne, 80 N.C. 291 (1879).

What Court May Grant Leave to Issue Execution. — The court which, under this section, may grant leave to issue execution is the court which has jurisdiction of probate matters, and no other court. Vaughn v. Stephenson, 69 N.C. 212 (1873).

§ 28A-18-6. Service by publication on executor without bond.

Whenever process may issue against an executor who has not given bond, and the same cannot be served upon him by reason of his absence or concealment, service of such process may be made by publication in the manner prescribed in other civil actions. (1868-9, c. 113, s. 94; Code, s. 1523; Rev., s. 163; C.S., s 167; 1973, c. 1329, s. 3.)

§ 28A-18-7. Execution by successor in office.

Any personal representative or collector may have execution issued on any judgment recovered by any person who preceded him in the administration of the estate, or by the decedent, in the same cases and the same manner as the original plaintiff might have done. (1868-9, c. 113, s. 84; Code, s. 1513; Rev., s. 164; C.S., s. 168; 1973, c. 1329, s. 3.)

§ 28A-18-8. Action to continue, though letters revoked.

In case the letters of a personal representative or collector are revoked, pending an action to which he is a party, the adverse party may, notwithstanding, continue the action against him in order to charge him personally. If such party does not elect so to do, within six months after notice of such revocation, the action may be continued against the successor of the personal representative or collector in the administration of the estate, in the same manner as in case of death. (1868-9, c. 113, s. 85; Code, s. 1514; Rev., s. 165; C.S., s. 169; 1973, c. 1329, s. 3.)

CASE NOTES

Cited in Champion v. PPG Indus., — F. Supp. 2d —, 2004 U.S. Dist. LEXIS 9034 (W.D.N.C. Apr. 2, 2004).

ARTICLE 19.

Claims Against the Estate.

§ 28A-19-1. Manner of presentation of claims.

(a) A claim against a decedent's estate must be in writing and state the amount or item claimed, or other relief sought, the basis for the claim, and the name and address of the claimant; and must be presented by one of the following methods:

(1) By delivery in person or by mail to the personal representative, collector or clerk of superior court. Such claim will be deemed to have been presented from the time of such delivery.

(2) By mailing, registered or certified mail, return receipt requested, to the personal representative or collector at the address set out in the general notice to creditors. Such claim will be deemed to have been presented from the time when the return receipt is signed by the personal representative, collector, or his agent, or is refused by the personal representative, collector, or his agent.

(3) By delivery to the clerk of court of the county in which the estate is pending, which notice shall be filed in the appropriate estate file and copy mailed first class by the clerk of superior court at the expense of the claimant to the personal representative, collector, or his agent. The claim will be deemed to have been presented from the time of delivery to the clerk of court.

(b) In an action commenced after the death of the decedent against his personal representative or collector as such, the commencement of the action in the court in which such personal representative or collector qualified will constitute the presentation of a claim and no further presentation is necessary. In an action filed in any other court such claim will be deemed to have been presented at the time of the completion of service of process on such personal representative or collector.

(c) In an action pending against the decedent at the time of his death, which action survives at law, the substitution of the personal representative or collector for the decedent or motion therefor will constitute the presentation of a claim and no further presentation is necessary. Such claim will be deemed to have been presented from the time of the substitution, or motion therefor. (1973, c. 1329, s. 3; 1977, c. 446, s. 1; 1985, c. 645, s. 1.)

CASE NOTES

No Preemption by ERISA. — The Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq., does not preempt this section and G.S. 28A-19-3 in action by plaintiffs who challenged the acts of several defendants involving the seizure of surplus assets from a retirement plan and the use of an annuity backed by junk bonds to increase to monetary amount of the surplus seized. Riley v. Murdock, 828 F. Supp. 1215 (E.D.N.C. 1993), aff'd, 83 F.3d 415 (4th Cir. 1996), cert. denied, 519 U.S. 964, 117 S. Ct. 387, 136 L. Ed. 2d 304 (1996).

Failure to Properly Present Claim. — Claimants' notice of claim against the decedent's estate was barred under G.S. 28A-19-3(a), where, among other things, the claimants failed to state the amount or item claimed, the particular basis for their claim, and the dates upon which services were rendered as was required under G.S. 28A-19-1(a). Holloman v. Harrelson, 149 N.C. App. 861, 561 S.E.2d 351, 2002 N.C. App. LEXIS 304 (2002), cert. dismissed, 355 N.C. 748, 565 S.E.2d 664 (2002), cert. denied, 355 N.C. 748, 565 S.E.2d 665 (2002).

Applied in In re Watson, 70 N.C. App. 120, 318 S.E.2d 544 (1984).

Cited in Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994); Pierce v. Johnson, 154 N.C. App. 34, 571 S.E.2d 661, 2002 N.C. App. LEXIS 1406 (2002).

§ 28A-19-2. Further information or affidavit of claim may be required.

(a) If the personal representative or collector so elects, he may demand any or all of the following prior to taking action on the claim:

(1) If the claim is not yet due, that the date when it will become due be stated;

(2) If the claim is contingent or unliquidated, that the nature of the uncertainty be stated;

(3) If the claim is secured, that the security be described.

(b) Upon any claim being presented against the estate in the manner prescribed in G.S. 28A-19-1, the personal representative or collector may require the affidavit of the claimant or other satisfactory evidence that such claim is justly due, that no payments have been made thereon, and that there are no offsets against the same, to the knowledge of the claimant; or if any payments have been made, or any offsets exist that their nature and amount be shown by the evidence or stated in the affidavit. (1868-9, c. 113, s. 33; Code, s. 1425; Rev., s. 91; C.S., s. 98; 1973, c. 1329, s. 3; 1977, c. 446, s. 1.)

§ 28A-19-3. Limitations on presentation of claims.

(a) All claims against a decedent's estate which arose before the death of the decedent, except contingent claims based on any warranty made in connection with the conveyance of real estate and claims of the United States and tax claims of the State of North Carolina and subdivisions thereof, whether due or to become due, absolute or contingent, liquidated or unliquidated, secured or unsecured, founded on contract, tort, or other legal basis, which are not presented to the personal representative or collector pursuant to G.S. 28A-19-1 by the date specified in the general notice to creditors as provided for in G.S. 28A-14-1(a) or in those cases requiring the delivery or mailing of notice as provided for in G.S. 28A-14-1(b), within 90 days after the date of the delivery or mailing of the notice if the expiration of said 90-day period is later than the date specified in the general notice to creditors, are forever barred against the estate, the personal representative, the collector, the heirs, and the devisees of the decedent. Provided further, if the expiration of said 90-day period is later than the date specified in the general notice to creditors, the notice delivered or mailed to each creditor, if any, shall be accompanied by a statement which specifies the deadline for filing the claim of the affected creditor.

(b) All claims against a decedent's estate which arise at or after the death of the decedent, except claims of the United States and tax claims of the State of North Carolina and subdivisions thereof whether due or to become due, absolute or contingent, liquidated or unliquidated, secured or unsecured, founded on contract, tort, or other legal basis are forever barred against the estate, the personal representative, the collector, the heirs, and the devisees of the decedent unless presented to the personal representative or collector as follows:

(1) With respect to any claim based on a contract with the personal representative or collector, within six months after the date on which performance by the personal representative or collector is due;

(2) With respect to any claim other than a claim based on a contract with the personal representative or collector, within six months after the date on which the claim arises.

(c) Except as otherwise provided by subsection (f) of this section, no claim shall be barred by the statute of limitations which was not barred thereby at the time of the decedent's death, if the claim is presented within the period provided by subsection (a) hereof.

(d) All claims of creditors upon whom there has been personal service of notice as provided in G.S. 28A-14-3 are forever barred unless presented to the personal representative or collector within the time and manner set out in this Article.

(e) Except as otherwise provided by subsection (f) of this section, unless a claim has been presented pursuant to G.S. 28A-19-1 giving notice of an action or special proceeding pending against a decedent at the time of his death and surviving under G.S. 28A-18-1 within the time provided by subsection (a) of this section, no recovery may be had upon any judgment obtained in any such action or proceeding against the estate, the personal representative, the collector, the heirs, and the devisees of the decedent.

(f) All claims barrable under the provisions of subsections (a) and (b) hereof shall, in any event, be barred if the first publication or posting of the general notice to creditors as provided for in G.S. 28A-14-1 does not occur within three years after the death of the decedent.

(g) Nothing in this section affects or prevents any action or proceeding to enforce any mortgage, deed of trust, pledge, lien (including judgment lien), or other security interest upon any property of the decedent's estate, but no deficiency judgment will be allowed if the provisions of this section are not complied with.

(h) The word "claim" as used in this section does not apply to claims of heirs or devisees to their respective shares or interests in the decedent's estate in their capacity as such heirs or devisees.

(i) Nothing in this section shall bar:

(1) Any claim alleging the liability of the decedent or personal representative; or

(2) Any proceeding or action to establish the liability of the decedent or personal representative; or

(3) The recovery on any judgment against the decedent or personal representative

to the extent that the decedent or personal representative is protected by insurance coverage with respect to such claim, proceeding or judgment or where there is underinsured or uninsured motorist coverage that might extend to such claim, proceeding, or judgment. (1973, c. 1329, s. 3; 1977, c. 446, s. 1; 1979, c. 509, s. 1; 1989, c. 378, s. 3; c. 485, s. 65.)

Legal Periodicals. — For survey of 1980 property law, see 59 N.C.L. Rev. 1209 (1981).

For note on statute of limitations accrual in attorney malpractice actions, in light of Thorpe v. DeMent, 69 N.C. App. 355, 317 S.E.2d 692, aff'd per curiam, 312 N.C. 488, 322 S.E.2d 777 (1984), see 20 Wake Forest L. Rev. 1017 (1984).

CASE NOTES

Purpose. — This section is the type of statute that is commonly referred to as a "nonclaim statute" and although similar to a statute of limitations, it serves a different purpose and operates independently of the statute of limitations that may also be applicable to a given claim. Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

Limitations on the filing of an action are applicable to statutes of limitations which restrict the assertion of legal rights to a specific time period in order to avoid stale claims, and a cause of action may be barred by this section, G.S. 1-52(5), or both of these statutes. Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

No Preemption by ERISA. — The Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq., does not preempt G.S. 28A-19-1 and this section in action by plaintiffs who challenged the acts of several defendants involving the seizure of surplus assets from a retirement plan and the use of an annuity backed by junk bonds to increase to monetary amount of the surplus seized. Riley v. Murdock, 828 F. Supp. 1215 (E.D.N.C. 1993), aff'd, 83 F.3d 415 (4th Cir. 1996), cert. denied, 519 U.S. 964, 117 S. Ct. 387, 136 L. Ed. 2d 304 (1996).

Proof of Advertisement Required. — When an administrator or executor pleads subsection (a) of this section as a defense against claims presented against the estate, he must establish the fact that he did advertise as required by G.S. 28A-14-1. Failure of such proof causes failure of the defense. Anderson v. Gooding, 300 N.C. 170, 265 S.E.2d 201 (1980).

Filing of Claim in Court Not Required. — Section 28A-19-1 sets out the manner of presentation of claims including some circumstances under which the filing of an action in a court of law may constitute the presentation of a claim; however, this section does not require the filing of an action in a court of law. Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

Language of subsection (i) provides an exception to limitations only for claims where there is insurance under which a decedent was insured. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 232 N.C. 171, 373 S.E.2d 104 (1988).

Action Not Time Barred. — Action filed on October 20, 2000, two days after qualification of deceased driver's personal representative, for personal injuries arising out of an automobile accident that occurred on June 27, 1997, was not barred by G.S. 1-52, where deceased died on November 7, 1997, at which time the three year limitations period had not yet expired, as under G.S. 28A-18-1 plaintiff's cause of action survived his death, and thus, pursuant to G.S. 1-22, plaintiff was permitted to commence a cause of action against deceased's personal representative, provided that either the action was brought within the time specified for the presentation of claims in G.S. 28A-19-3, or that notice of the claim upon which the action was based was presented to the personal representative within the time specified for the presentation of claims in G.S. 28A-19-3. The personal representative's failure to establish in the record that she complied with G.S. 28A-19-3(a) regarding general notice to creditors precluded her from relying upon the statute of limitations as a bar; moreover, under G.S. 28A-14-1(a), the absolute earliest "deadline" date which could have been specified by the personal representative in the general notice to creditors was January 18, 2001, three months from the day of the first publication or posting of such notice. Mabry v. Huneycutt, 149 N.C. App. 630, 562 S.E.2d 292, 2002 N.C. App. LEXIS 271 (2002).

Recovery Limited After Six Months. — Automobile accident victim who filed suit more than six months after the accident was limited in his amount of recovery by the amount of the deceased defendant's automobile insurance. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 232 N.C. 171, 373 S.E.2d 104 (1988).

Claim Not Barred Where Personal Representative Was Not Appointed. — Plaintiffs' cause of action is not barred for failure to present the claim to the personal representative within the time prescribed by subsection (b) where no personal representative or collector had been appointed for the estate. Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

In light of North Carolina Supreme Court precedent, where no estate administrator had been appointed within the statute of limitations and there was insurance coverage that covered a victim's claim, the statute of limitations did not bar a victim's claim. Simpson v. McConnell, 156 N.C. App. 424, 576 S.E.2d 419, 2003 N.C. App. LEXIS 104 (2003).

Claim Not Barred If Personal Representative Appointed Before Limitations Period Expires. — If a personal representative is appointed to administer an estate before the expiration of the statute of limitations, G.S. 1-22 allows the time limit within which to file an action against the estate to be extended according to G.S. 28A-19-3. Shaw v. Mintz, 151 N.C. App. 82, 564 S.E.2d 593, 2002 N.C. App. LEXIS 674 (2002).

Extension of Statute of Limitations After Appointment of Personal Representative. — If a personal representative is appointed to administer an estate before the statute of limitations lapses, G.S. 1-22 will allow the time limit within which to file an action against the estate to be extended according to G.S. 28A-19-3. Wright v. Smith, 151 N.C. App. 121, 564 S.E.2d 613, 2002 N.C. App. LEXIS 681 (2002), cert. denied, 356 N.C. 696, 579 S.E.2d 106 (2003).

Under Subsection (i) Plaintiff Barred from Claim Greater Than Underinsurance Coverage. — Where, pursuant to subsection (i) of this section, all that plaintiff could recover from the underinsured decedent was the $25,000.00 coverage the decedent had under his policy with insurer, plaintiff, who was only legally entitled, by statute, to recover this amount, and nothing more, from decedent could not bring a claim for a greater amount against insurer under his underinsured motorist endorsement. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 232 N.C. 171, 373 S.E.2d 104 (1988).

Failure to Properly Present Claim. — Claimants' notice of claim against the decedent's estate was barred under G.S. 28A-19-3(a), where, among other things, the claimants failed to state the amount or item claimed, the particular basis for their claim, and the dates upon which the services were rendered as was required under G.S. 28A-19-1(a). Holloman v. Harrelson, 149 N.C. App. 861, 561 S.E.2d 351, 2002 N.C. App. LEXIS 304 (2002), cert. dismissed, 355 N.C. 748, 565 S.E.2d 664 (2002), cert. denied, 355 N.C. 748, 565 S.E.2d 665 (2002).

Order affirming a clerk's decision to set aside a prior reopening of a decedent's estate was proper because although shareholders filed a claim against the estate after it was reopened, they did not file a claim before the estate was closed; thus, the shareholders' claim was forever barred against the estate. In re Estate of Mullins, — N.C. App. —, 643 S.E.2d 599, 2007 N.C. App. LEXIS 798 (2007).

Notice to Creditors Held Fatally Defective. — An executor's general notice to creditors published in a newspaper was fatally defective where it failed to name a day after which claims would be barred and failed to give notice that claims must be filed within six months from the day of the first publication of the notice; therefore, the notice to creditors was ineffective to start the running of the six months' statute of limitations of subsection (a) of this section in bar of a claim against decedent's estate to recover for personal injuries received in an automobile accident. Anderson v. Gooding, 300 N.C. 170, 265 S.E.2d 201 (1980).

Wrongful Death Recovery Held Not Barred by Section. — The failure of a plaintiff to file a claim against a decedent's estate within the six months stipulated by this section does not bar recovery for wrongful death where plaintiff is seeking to collect damages out of an automobile liability insurance policy. Thorpe v. Wilson, 58 N.C. App. 292, 293 S.E.2d 675 (1982).

Garage and wrecker service owner, who had a valid lien incident to storage of defendant's vehicles pursuant to court order, could proceed against the property or the proceeds of its sale up to its value without filing the usual notice of claim under subsection (a) of this section, by virtue of subsection (g). Case v. Miller, 68 N.C. App. 729, 315 S.E.2d 737 (1984).

Claim for Compensation for Occupation of Property Not Barred Where Presented Within Period Under Section. — A landowner's claim for "reasonable compensation" for occupation of her property (G.S. 42-4), brought against one of the former co-tenants as administratrix of her husband's estate, was presented to the administratrix within the statutory period under this section and was therefor not barred by the three-year statute of limitations (G.S. 1-52(2)) as of the decedent's death. The landowner was allowed to sue the administratrix for rents not paid in the period of three years prior to the decedent's death, although the action itself was not brought until some six months after this date. Simon v. Mock, 75 N.C. App. 564, 331 S.E.2d 300 (1985).

Reopening of Estate After Six-Month Period. — The provision in G.S. 28A-23-5 prohibiting any claim which is already barred from being asserted in the reopened estate primarily refers to the limitations in this section on the presentation of claims. Thus, an estate may not ordinarily be reopened for the litigation of claims not brought within the six-month period, even in the absence of a bar by some other statute of limitations. In re Estate of English, 83 N.C. App. 359, 350 S.E.2d 379 (1986), cert. denied, 319 N.C. 403, 354 S.E.2d 711 (1987).

Refusal of Clerk to Reopen Upheld. — In light of the public policy in favor of the expedited administration of estates, as evidenced by the six-month statute of limitations and other provisions of this Chapter, petitioner who alleged that the deceased had promised to devise a life estate to her had a heavy burden of justifying her failure to bring her suit within the six-month period provided for that purpose, or at the very least, within the greater than two-year period that the estate actually remained open. There was no error in the clerk's determination that this burden was not met. In re Estate of English, 83 N.C. App. 359, 350 S.E.2d 379 (1986), cert. denied, 319 N.C. 403, 354 S.E.2d 711 (1987).

Recovery Limited to Extent of Decedent's Liability Insurance. — Trial court erred in denying the injured party's motion to amend the complaint because the injured party's error was a misnomer, the intended defendant (the executor) was served, and the amendment would not prejudice the executor; however, because the injured party did not present the claim to the estate in accordance with the non-claim statute, G.S. 28A-19-3, the injured party's recovery was limited to the extent of the decedent's liability insurance. Pierce v. Johnson, 154 N.C. App. 34, 571 S.E.2d 661, 2002 N.C. App. LEXIS 1406 (2002).

Applied in Anderson v. Gooding, 43 N.C. App. 611, 259 S.E.2d 398 (1979); Baer v. Davis, 47 N.C. App. 581, 267 S.E.2d 581 (1980); Force v. Sanderson, 56 N.C. App. 423, 289 S.E.2d 56 (1982); Lee v. Keck, 68 N.C. App. 320, 315 S.E.2d 323 (1984); Thorpe v. DeMent, 69 N.C. App. 355, 317 S.E.2d 692 (1984); Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991); State Farm Mut. Auto. Ins. Co. v. Blackwelder, 332 N.C. 135, 418 S.E.2d 229 (1992).

Cited in Joyner v. Wilson Mem. Hosp., 38 N.C. App. 720, 248 S.E.2d 881 (1978); Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979); Gelder & Assocs. v. Huggins, 52 N.C. App. 336, 278 S.E.2d 295 (1981); Carethers v. Blair, 53 N.C. App. 233, 280 S.E.2d 467 (1981); Lassiter v. Faison, 111 N.C. App. 206, 432 S.E.2d 373 (1993).

§ 28A-19-4. Payment of claims and charges.

As soon as the personal representative or collector is possessed of sufficient means over and above the other costs of administration, he shall pay the year's allowances in the amounts and in the manner prescribed in G.S. 30-15 to 30-33. Prior to the date specified in the general notice to creditors as provided for in G.S. 28A-14-1, the personal representative or collector may pay such other claims and charges as he deems in the best interest of the estate if the total assets are sufficient to pay all claims and charges against the estate. (1973, c. 1329, s. 3; 1977, c. 446, s. 1.)

§ 28A-19-5. Contingent claims.

If a contingent or unliquidated claim becomes absolute before the distribution of the estate of the decedent, it shall be paid in the same manner as absolute claims of the same class. In other cases the clerk of superior court may provide for the payment of contingent or unliquidated claims in any one of the following ways:

(1) The creditor and the personal representative or collector may determine, by agreement, arbitration, or compromise, the value of the contingent or unliquidated claim, according to its probable present worth, and with the approval of the clerk of superior court, it may be allowed and paid in the same manner as an absolute claim.

(2) The clerk of superior court may order the personal representative or collector to retain sufficient funds to pay the claim if and when the same becomes absolute, and order distribution of the balance of the estate.

(3) The clerk of superior court may order distribution of the estate as though the contingent or unliquidated claim did not exist, but the heirs and devisees of the estate of the decedent are liable to the creditor to the extent of the estate received by them, if the contingent or unliquidated claim thereafter becomes absolute; and the court may

require such heirs and devisees to give bond for the performance of their liability to the contingent or unliquidated creditor.

(4) Such other method as the clerk of superior court may order. (1973, c. 1329, s. 3.)

CASE NOTES

Applied in In re Watson, 70 N.C. App. 120, 318 S.E.2d 544 (1984).

Cited in Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

§ 28A-19-6. Order of payment of claims.

(a) After payment of costs and expenses of administration, the claims against the estate of a decedent must be paid in the following order:

First class. Claims which by law have a specific lien on property to an amount not exceeding the value of such property.

Second class. Funeral expenses to the extent of two thousand five hundred dollars ($2,500). This limitation shall not include cemetery lot or gravestone. The preferential limitation herein granted shall be construed to be only a limit with respect to preference of payment and shall not be construed to be a limitation on reasonable funeral expenses which may be incurred; nor shall the preferential limitation of payment in the amount of two thousand five hundred dollars ($2,500) be diminished by any Veterans Administration, social security or other federal governmental benefits awarded to the estate of the decedent or to his or her beneficiaries.

Third class. All dues, taxes, and other claims with preference under the laws of the United States.

Fourth class. All dues, taxes, and other claims with preference under the laws of the State of North Carolina and its subdivisions.

Fifth class. Judgments of any court of competent jurisdiction within the State, docketed and in force, to the extent to which they are a lien on the property of the decedent at his death.

Sixth class. Wages due to any employee employed by the decedent, which claim for wages shall not extend to a period of more than 12 months next preceding the death; or if such employee was employed for the year current at the decease, then from the time of such employment; for medical services within the 12 months preceding the decease; for drugs and all other medical supplies necessary for the treatment of such decedent during the last illness of such decedent, said period of last illness not to exceed 12 months.

Seventh class. A claim for equitable distribution.

Eighth class. All other claims.

(b) Notwithstanding subsection (a) of this section, if payment of the commissions of the personal representative under G.S. 28A-23-3(g) would cause the estate to be unable to pay all claims against the estate of a decedent, then the commissions shall be limited to the amount allowed under G.S. 28A-23-3(a). (1868-9, c. 113, s. 24; Code, s. 1416; Rev., s. 87; C.S., s. 93; 1941, c. 271; 1955, c. 641, s. 1; 1967, c. 1066; 1973, c. 1329, s. 3; 1981, c. 383, ss. 1, 2; 1987, c. 286; 1995, c. 262, s. 8; 2005-180, s. 1; 2005-388, s. 2.)

Cross References. — As to funeral expenses, see G.S. 28A-19-8. As to authority to provide for gravestones, see G.S. 28A-19-9. As to perpetual care of cemetery lot, see G.S. 28A-19-10. As to commissions allowed representatives, see G.S. 28A-23-3. As to counsel fees allowable to attorneys serving as representatives, see G.S. 28A-23-4. As to disbursement by clerk of superior court, see G.S. 28A-25-6.

Editor's Note. — Session Laws 2005-180, s. 2, effective July 12, 2005, which amended subsection (a), applies to the estates of persons who died on or after June 12, 2003, provided that an agreement entered into or performed pursuant to G.S. 28A-19-19(b) before July 12, 2005 is not affected by this act.

Effect of Amendments. — Session Laws 2005-388, s. 2, effective January 1, 2006, and applicable to commissions paid on or after that date, designated the existing provisions as subsection (a); and added subsection (b).

CASE NOTES

I. General Consideration.
II. Specific Liens on Property.
III. Funeral Expenses.
IV. Dues, Taxes, and Claims under Federal Law.
V. Dues, Taxes, and Claims under State Law.
VI. Judgment Liens.
VII. Medical Expenses.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

The intention of the legislature is that the assets of a decedent shall be administered, as far as may be done, in one proceeding, upon proper safeguards, for the benefit of all the creditors. Atkinson v. Ricks, 140 N.C. 418, 53 S.E. 230 (1906).

Priorities Among Creditors Established. — This section was only designed to recognize priorities among the creditors of the deceased and to establish the order of payment between claimants who have valid debts against the deceased. It was never intended to create a liability which did not otherwise exist. Bowen v. Daugherty, 168 N.C. 242, 84 S.E. 265 (1915).

Recognizing priority of classes, this section provides for the administration of assets for the benefit of all the creditors, according to definite and established rules. Farmville Oil & Fertilizer Co. v. Bourne, 205 N.C. 337, 171 S.E. 368 (1933).

Strict Construction. — This section, being in derogation of the equity of a pro rata distribution, should be strictly construed so as not to confer a priority over other creditors unless it is clearly called for. Baker v. Dawson, 131 N.C. 227, 42 S.E. 588 (1902); Park View Hosp. Ass'n v. People's Bank & Trust Co., 211 N.C. 244, 189 S.E. 766 (1937); Underwood v. Ward, 239 N.C. 513, 80 S.E.2d 267 (1954).

If decedent's estate is not sufficient to pay his debts in full, then they are to be paid in classes, with those of the last class, if and when reached, sharing ratably in what is left. Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).

Duty of Representative. — To carry out the order designated by this section is a duty of the representative. State v. Oliver, 104 N.C. 458, 10 S.E. 709 (1889).

Testator Cannot Change Statutory Priority. — A testator may not so dispose of his estate as to avoid the payment of his debts in accordance with the priorities fixed by this section. First Sec. Trust Co. v. Lentz, 196 N.C. 398, 145 S.E. 776 (1928).

Where debtor's lands are sold under order of court to make assets, proceeds remain real estate until all liens are discharged, and are to be applied to payment of liens in the order of their priority, and only the residue, if any, is payable to administrator as personal property to be distributed in the order provided by this section. Moore v. Jones, 226 N.C. 149, 36 S.E.2d 920 (1946), citing Murchison v. Williams, 71 N.C. 135 (1874). See Williams v. Johnson, 230 N.C. 338, 53 S.E.2d 277 (1949).

Creditor Must First Exhaust Security. — Upon the death of an obligor the administration laws step in and determine the settlement of his estate. These have heretofore been construed by the Supreme Court to favor the bankruptcy rule. Thus a secured creditor is required to exhaust his security and then prove his claim for any balance still remaining or unpaid. Rierson v. Hanson, 211 N.C. 203, 189 S.E. 502 (1937).

Holder of Secured Note Must Exhaust Security and Then File Claim for Balance. — The holder of a note executed or assumed by the deceased, and secured by a deed of trust or mortgage, must first exhaust the security and apply the same on the debt, and may then file a claim against the estate for the balance due, if any. But the holder of such note may not file claim and receive pro rata dividend on the basis of the full claim. Montsinger v. White, 240 N.C. 441, 82 S.E.2d 362 (1954).

Execution on a personal money judgment after the death of the debtor is barred. The holder of the judgment must look to the duly appointed administrator for payment of the judgment according to the priorities prescribed by this section. Henderson County v. Osteen, 28 N.C. App. 542, 221 S.E.2d 903 (1976), rev'd on other grounds, 292 N.C. 692, 235 S.E.2d 166 (1977).

Validity of Unrecorded Chattel Mortgage Not Affected. — This statutory provision does not bear upon whether an unrecorded chattel mortgage, valid as against the intestate, is to like extent valid against his estate.

Coastal Sales Co. v. Weston, 245 N.C. 621, 97 S.E.2d 267 (1957).

This section creates no preference for payment on bank stock out of the assets of the estate of a deceased stockholder, and none results from the application of the pertinent principles of equity. Hood v. Darden, 206 N.C. 566, 174 S.E. 460 (1934).

Claim by Former Spouse. — Distributive award that the trial court entered in favor of an ex-wife after her former husband died was not part of the husband's estate, and the trial court properly ordered the husband's personal representative to pay the award before she paid claims against the estate. Painter-Jamieson v. Painter, 163 N.C. App. 527, 594 S.E.2d 217, 2004 N.C. App. LEXIS 400 (2004).

Fees of a referee taxed against an administrator are not a preferred debt under this section. Cobb v. Rhea, 137 N.C. 295, 49 S.E. 161 (1904), petition to rehear dismissed, 140 N.C. 650, 52 S.E. 1038 (1905).

Where debtor's lands are sold under order of court to make assets, no part of the proceeds may be taxed with costs of administration. However, a referee's fee by G.S. 6-21 is taxable in the discretion of the court. Williams v. Johnson, 230 N.C. 338, 53 S.E.2d 277 (1949).

II. SPECIFIC LIENS ON PROPERTY.

The evident purpose of this section relating to debts of the first class is to benefit the estate, particularly the creditors thereof next in line for payment. Underwood v. Ward, 239 N.C. 513, 80 S.E.2d 267 (1954).

No Equity Preserved in Land in Which Estate Has No Interest. — Since the priority of the first class is limited to a situation where the value of the property equals or exceeds the amount of the specific lien thereon, the personal representative may preserve any equity for the benefit of other creditors and of beneficiaries. But where the estate and its creditors and beneficiaries have no right, title or interest in the real property on which the creditor has a specific lien, no equity can be preserved. Underwood v. Ward, 239 N.C. 513, 80 S.E.2d 267 (1954).

Notes Secured by Liens on Lands Held by Entireties. — Husband and wife were jointly and severally liable on notes secured by liens on lands held by them by entireties. Upon the death of the husband, the liability of his estate for one half the balance due on the notes at the time of his death is not a debt coming within the first class of priority, since even though the debt is secured by specific lien on the property, the property is not an asset of the estate. Underwood v. Ward, 239 N.C. 513, 80 S.E.2d 267 (1954).

A deed of trust executed to secure a debt which by laws had a specific lien on property, as provided by the first class, has priority over the payment of taxes provided for eo nomine in the third class. Farmville Oil & Fertilizer Co. v. Bourne, 205 N.C. 337, 171 S.E. 368 (1933).

Judgment Lien Is Not "Specific Lien on Property". — The lien of a docketed judgment, which is eo nomine put in the fifth class, is not a "specific lien on property," unless made so by its terms, as to come within the first class mentioned in this section. Stewart v. Doar, 205 N.C. 37, 169 S.E. 804 (1933).

But Section Does Not Nullify Judgment Lien. — There is nothing in this section, or in any other provision of the law, that indicates intent to nullify the lien of a docketed judgment or to destroy any right acquired under the law prior to the death of the judgment debtor. Moore v. Jones, 226 N.C. 149, 36 S.E.2d 920 (1946).

Tax Liens Take Priority Over Estate Administration Costs. — The conflict between this section and G.S. 105-356 was resolved in favor of city and county/appellants who sought to recover back taxes and interest through a foreclosure proceeding on property, although the guardian ad litem and public administrator asserted that such foreclosure would cause the tax lien to take precedence over the costs of estate administration in violation of this section and would result in inequity should the sale fail to render sufficient funds to cover both taxes and costs. City of Durham v. Hicks, 135 N.C. App. 699, 522 S.E.2d 583, 1999 N.C. App. LEXIS 1227 (1999).

III. FUNERAL EXPENSES.

Funeral and Medical Expenses Are of Debtor Only. — The funeral and medical expenses referred to in the paragraphs designated "Second class" and "Sixth class" are those of the debtor, and not of his wife, child or tenants. Baker v. Dawson, 131 N.C. 227, 42 S.E. 588 (1902).

Husband's estate is liable for funeral expenses of his predeceased wife, in preference to the beneficiaries under his will. Bowen v. Daugherty, 168 N.C. 242, 84 S.E. 265 (1915).

Third Party Paying. — The provisions of the paragraph designated "Second class," inure to the benefit of one who after having paid such expenses as a matter of affection and duty wants to recover the same from the estate. Ray v. Honeycutt, 119 N.C. 510, 26 S.E. 127 (1896).

IV. DUES, TAXES, AND CLAIMS UNDER FEDERAL LAW.

Federal Estate Tax. — See Wachovia Bank & Trust Co. v. Green, 236 N.C. 654, 73 S.E.2d 879 (1953); Tolson v. Young, 260 N.C. 506, 133 S.E.2d 135 (1963); Adams v. Adams, 261 N.C. 342, 134 S.E.2d 633 (1964).

V. DUES, TAXES, AND CLAIMS UNDER STATE LAW.

Tax Judgment under § 105-375 Does Not Affix Lien on Property. — As a judgment against the property of the listed taxpayer, directing the sale of the property to satisfy the tax lien, the tax judgment established under G.S. 105-375 is not a "debt" within the meaning of former G.S. 28-105, nor does it affix a lien to the taxpayer's property. Henderson County v. Osteen, 28 N.C. App. 542, 221 S.E.2d 903 (1976), rev'd on other grounds, 292 N.C. 692, 235 S.E.2d 166 (1977).

It represents a final order for the sale of the delinquent taxpayer's property. Henderson County v. Osteen, 28 N.C. App. 542, 221 S.E.2d 903 (1976), rev'd on other grounds, 292 N.C. 692, 235 S.E.2d 166 (1977).

Distinction Between Tax Judgment Strictly in Rem and in Personam Judgment. — See Henderson County v. Osteen, 28 N.C. App. 542, 221 S.E.2d 903 (1976), rev'd on other grounds, 292 N.C. 692, 235 S.E.2d 166 (1977).

Method of Collecting Taxes. — Former G.S. 105-412 indicated that the ordinary methods of collecting taxes by a sheriff do not apply to collection of taxes from a decedent's estate. Sherrod v. Dawson, 154 N.C. 525, 70 S.E. 739 (1911).

Taxes Assessed against Life Tenant. — See Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).

Tax-Sale Certificate Is Not a Preferred Claim. — A tax-sale certificate in the hands of a remainderman, representing taxes paid by the remainderman during the lifetime of the life tenant, may not be proved as a preferred claim against the estate of the life tenant, since the remainderman's sole remedy upon the tax-sale certificate is by foreclosure under the provisions of former C.S., G.S. 8028 (see now G.S. 47-108.25). Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).

Former provisions that taxes should be paid by the personal representative in the third class of priority had no application to the statutory action to foreclose a tax-sale certificate. Guilford County v. Estates Admin., 213 N.C. 763, 197 S.E. 535 (1938).

Nor Are Assessments for Public Improvements. — See Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).

This section has no application to the payment of assessments made against land by a municipality for the purpose of improving streets. City of High Point v. Brown, 206 N.C. 664, 175 S.E. 169 (1934); Town of Saluda v. County of Polk, 207 N.C. 180, 176 S.E. 298 (1934).

Or to Charges for Water and Gas Connections. — Charges for water and gas connections, incurred during the lifetime of a life tenant and unpaid at his death, do not constitute a preferred claim against his estate as taxes assessed on the estate prior to his death, since in no event would such charges stand upon a higher plane than assessments for permanent improvements. Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).

VI. JUDGMENT LIENS.

Application of Fifth Class Provision to Funds in Administrator's Hands. — The provision of the paragraph designated "Fifth class" applies to funds in the administrator's hands. Matthews v. Peterson, 150 N.C. 134, 63 S.E. 721 (1909).

Judgments Paid Out of Personalty. — The paragraph designated "Fifth class" does not mean that the judgment shall be paid out of the realty of the decedent upon which it has become a lien. When a debtor dies, against whom there is a judgment docketed, his land descends to his heirs or vests in his devisees, and his personal property vests in his administrator or executor, just as if there were no judgment against him, and the whole estate is to be administered just as if there were no judgment, that is to say, the personal property must be sold, if necessary, and all the personal assets collected, and out of these personal assets all the debts must be paid, if there be enough to pay all docketed judgments as well as others. The reason for this mode of administration is that, although a lien on land exists, the judgment should be paid out of the personal estate, if any, in exoneration of the land for the benefit of the heir or devisee. Lee v. Eure, 82 N.C. 428 (1880).

Creditor Must File Claim. — If a judgment creditor wishes to share in the distribution of the personal estate of his deceased judgment debtor, and to protect himself against the running of the statute of limitations as against the debt (G.S. 1-22), he must file his claim with the personal representative of the deceased. Williams v. Johnson, 230 N.C. 338, 53 S.E.2d 277 (1949).

Extent of Lien. — If the real estate upon which the judgment is a lien is of less value than the amounts of the judgment, then the extent of the lien is the value of the land only. Jerkins v. Carter, 70 N.C. 500 (1874).

If the real estate upon which the judgment is a lien is of less value than the amount of the judgment, and a part of the lien has been paid out of the personalty (which is first liable for the payment) the extent of the lien is the difference between the value of the land and the amount paid out of the personalty. It is not the difference between the amount of the lien and the amount paid from the personalty. Murchison v. Williams, 71 N.C. 135 (1874).

When Priorities Determined. — The priorities among judgment creditors, which are dependent upon the date of their respective recordation, are to be determined as they existed at the death of the debtor, after which they remain unaffected by lapse of time until barred by the statute of limitations or by executions issued upon the judgments. Town of Tarboro v. Penders, 153 N.C. 427, 69 S.E. 425 (1910); Farmville Oil & Fertilizer Co. v. Bourne, 205 N.C. 337, 171 S.E. 368 (1933).

Priority over Mortgage. — Where realty sold under order of court to make assets is subject to a docketed judgment and a subsequently recorded mortgage, the judgment must be satisfied in full before application of any part of the proceeds to the mortgage or to the payment of other debts. Moore v. Jones, 226 N.C. 149, 36 S.E.2d 920 (1946).

Statute of Limitations Not Affected. — The fact that judgments docketed and in force, which have become a lien upon decedent's property at the date of his death, have priority over certain other claims, does not stop the running of the statute of limitations upon such judgments. Daniel v. Laughlin, 87 N.C. 433 (1882).

The expiration of the judgment lien terminates the authority of the representative to pay such lien. The judgment lien must be in force at the time of payment. Matthews v. Peterson, 150 N.C. 132, 63 S.E. 721 (1909).

Application of Proceeds under a Consent Judgment to Sell Lands. — Where a consent judgment provided that a commissioner be appointed to sell certain lands of a deceased person and pay the net proceeds to the administratrix of the deceased to pay the debts of his estate, the distribution of these proceeds was thereunder to be made under the provisions of this section, and a judgment ordering them to be paid to satisfy the lien of a judgment creditor on the lands of the estate, adjudging it a prior lien, was reversible error. First Nat'l Bank v. Mitchell, 191 N.C. 190, 131 S.E. 656 (1926).

VII. MEDICAL EXPENSES.

The words "medical services," include all services rendered to the deceased, because of his illness, upon the advice of his physician, which were reasonably necessary for his care and comfort and for his proper treatment by his physicians. Park View Hosp. Ass'n v. People's Bank & Trust Co., 211 N.C. 244, 189 S.E. 766 (1937).

Board of Graduate Nurses Included in Medical Services. — The board of graduate nurses, who attended the deceased while he was a patient in plaintiffs' hospital, was a claim included in the term "medical services" as used in this section. Park View Hosp. Ass'n v. People's Bank & Trust Co., 211 N.C. 244, 189 S.E. 766 (1937).

Termination of Old Age Assistance. — When old age assistance was terminated by death of the recipient, the county's claim against the recipient's estate under former G.S. 108-30.1 had to be satisfied out of the personal property in the estate to the extent it was sufficient to pay claims of the sixth class before resorting to the real property for satisfaction of the debt. Brunswick County v. Vitou, 6 N.C. App. 54, 169 S.E.2d 234 (1969).

OPINIONS OF ATTORNEY GENERAL

Priority of Portion of Funeral Bill Not a Limitation on Amount. — See opinion of Attorney General to Mrs. Martha O. Comer, CSC, 40 N.C.A.G. 30 (1970), issued under prior law.

§ 28A-19-7. Satisfaction of claims other than by payment.

Notwithstanding any provision of law to the contrary,

(1) If a decedent was liable in person at the time of his death for the payment or satisfaction of any claim or the performance, satisfaction, or discharge of any liability or obligation, whether joint or several, primary or secondary, direct or contingent, or enforceable in any other manner or form whatsoever, or

(2) If only the property of a decedent or some part thereof was liable at the time of his death for the payment or satisfaction of any claim or the performance, satisfaction, or discharge or any liability or obligation, whether joint or several, primary or secondary, direct or contingent, or enforceable in any other manner or form against the property of the decedent but not against him or his estate as a personal liability, and

(3) If any person other than the personal representative of the decedent is willing to assume the liability of the decedent and of his estate or to

receive or accept property of the decedent subject to such liability in cases where the decedent was not personally liable and the creditor, obligee, or other person for whose benefit such liability exists is willing to accept an agreement with that effect and to discharge the personal representative of the decedent and the estate of the decedent from the payment, satisfaction, or discharge of such liability, and

(4) If such creditor, obligee, or other person for whose benefit such liability exists and the person assuming the liability or the person receiving or accepting property of the decedent subject to such liability shall execute, acknowledge, and deliver in the form and manner required for deeds conveying real property in North Carolina, an agreement between themselves as to such assumption of liability or the receipt or acceptance of property of the decedent subject to such liability which shall contain a release, as hereinafter defined, discharging the personal representative of the decedent and his estate from the payment, satisfaction, or discharge of the liability, and thereafter the said creditor, obligee, or other person for whose benefit such liability exists shall have no remedy for the enforcement thereof except against the person assuming it or against the property subject to it as provided in the said agreement; then upon the filing with the clerk of superior court having jurisdiction over the estate and the personal representative of one duplicate original of the said agreement, or of a certified copy thereof if it is a duly recorded instrument, the same shall be accepted in the same manner as a voucher showing payment or discharge of the said liability in the accounts of the personal representative of the decedent.

The word "person" as used in this section shall include one or more natural persons, corporations, partnerships, or entities having the power to own property or to make contracts in regard thereto. The word "release" as used in this section shall include a covenant not to sue in any case in which an unqualified release or discharge of one obligee would discharge another, and if the liability involved is a negotiable instrument or other instrument transferable to a holder in due course, such release shall not be effective unless notice thereof is endorsed on the instrument involved, dated, and signed by the creditor or the holder of the indebtedness or person for whose benefit the property is encumbered. (1965, c. 1149; 1973, c. 1329, s. 3.)

§ 28A-19-8. Funeral expenses of decedent.

(a) Any person authorized under G.S. 130A-420 to dispose of a decedent's body may bind a decedent's estate for funeral expenses and related charges, including interest and finance charges, in accordance with this section, including the execution and delivery on behalf of the estate of any agreements, promissory notes, and other instruments relating to the estate. Whether or not a personal representative of the estate has been appointed at the time the expenses are incurred, funeral expenses of a decedent, together with interest or finance charges if financed by the funeral establishment or a third-party creditor, shall be considered as an obligation of the estate of the decedent and the decedent's estate shall be primarily liable for those expenses to the funeral establishment that provided the funeral service, to any third-party creditor that finances the payment of those expenses, or to any other person described in this section who has paid such expenses.

(b) The provisions of this section shall not affect the application of G.S. 28A-19-6 or G.S. 130A-420. (1969, c. 610, s. 1; 1973, c. 1329, s. 3; 1999-166, s. 1.)

Legal Periodicals. — For legislative survey of trusts and estates, see 22 Campbell L. Rev. 253 (2000).

CASE NOTES

Section Does Not Limit Collection of Expenses Exclusively to an Estate. — This section does not limit collection of funeral expenses exclusively to the estate. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991).

Other Person's Promise to Pay Funeral Expenses. — Defendant's alleged promise to pay funeral expenses for his deceased father if the estate did not was a promise to pay the debt of another, which is void by law unless in writing. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991), holding, however, that as defendants did not specifically plead the statute of frauds, it was not available as a defense.

§ 28A-19-9. Gravestone authorized.

It is lawful for personal representatives to provide suitable gravestones to mark the graves of their testators or intestates, and to pay for the cost of erecting the same and the cost thereof shall be paid as funeral expenses and credited as such in final accounts. The costs thereof shall be in the sound discretion of the personal representative, having due regard to the value of the estate and to the interests of creditors and needs of the surviving spouse and the heirs and devisees of the estate. Where the personal representative desires to spend more than four hundred dollars ($400.00) for such purpose, and the will does not grant specific authority to the personal representative for such expenditures in excess of four hundred dollars ($400.00), he shall file his petition before the clerk of the court, and such order as will be made by the court shall specify the amount to be expended for such purpose. Provided, however, that if the net estate is of a value in excess of twenty-five thousand dollars ($25,000), the personal representative may, in his discretion, expend not more than eight hundred dollars ($800.00) for this purpose without securing the order of the court required herein. If the estate is of a value in excess of twenty-five thousand dollars ($25,000) and the personal representative desires to spend more than eight hundred dollars ($800.00) for such purpose, and the will does not grant specific authority for such expenditure he shall file his petition and secure the order of the court herein required before expending funds for such purpose. However, in no event may more than eight hundred dollars ($800.00) be accounted as gravestone marker cost to be credited as a funeral expense in the final accounts. (1905, c. 444; Rev., s. 102; C.S., s. 108; 1925, c. 4; 1941, c. 102; 1951, c. 373; 1973, c. 1329, s. 3.)

CASE NOTES

This section was held inapplicable where executors, in obedience to testamentary instructions, expended more than $100 [now $400] for a gravestone without order of court, when the estate appeared to be solvent, though in fact it was insolvent. In re Estate of Bost, 211 N.C. 440, 190 S.E. 756 (1937), decided under prior law.

§ 28A-19-10. Perpetual care of cemetery lot.

It shall be lawful for a personal representative to provide for perpetual care for the lot upon which is located the grave of the testator or intestate, and the cost thereof shall be paid and credited as such in final accounts: Provided, that the provisions of this section shall be applicable to an interment made in a cemetery authorized by law to operate as a perpetual-care cemetery or association, and the cost thereof shall be in the sound discretion of the personal representative having due regard to the value of the estate and to the interest of the surviving spouse and the heirs and devisees of the estate. Provided, where the personal representative desires to spend more than two hundred fifty dollars ($250.00) for such purpose, and the will does not grant specific authority to the personal representative for such expenditure in excess of two hundred fifty dollars ($250.00), he shall file his petition before the clerk of the superior court and such order as will be made by the court shall specify the amount to be expended for such purpose. (1945, c. 756; 1973, c. 1329, s. 3.)

§ 28A-19-11. Pleading statute of limitations.

When claims are not barred pursuant to G.S. 28A-19-3, it shall be within the discretion of the personal representative or collector acting in good faith to determine whether or not any applicable statute of limitations shall be pleaded to bar a claim which he believes to be just. His admission of such claim or his decision not to plead the statute in an action brought on the claim shall, in the absence of any showing of collusion or bad faith, be binding on all persons interested in the estate. (1973, c. 1329, s. 3.)

§ 28A-19-12. Claims due representative not preferred.

No property or assets of the decedent shall be retained by the personal representative or collector in satisfaction of his own claim, in preference to others of the same class. Prior to payment of his own claim the personal representative shall receive written approval of the clerk of superior court. If the clerk does not approve the claim the personal representative may refer the claim as a disputed claim under the provisions of G.S. 28A-19-15. The provisions of G.S. 28A-19-1 and G.S. 28A-19-3 shall not apply to such claims and the personal representative may present his own claim at any time prior to the filing of his final account. (1868-9, c. 113, s. 28; Code, s. 1420; Rev., s. 89; C.S., s. 96; 1973, c. 1329, s. 3; 1979, c. 525, s. 4.)

CASE NOTES

Attorneys' Fees and Commissions. — This section does not apply to the payment of attorneys' fees and commissions. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Claims by Personal Representative. — This section applies to "claims" against the estate, such as liens against property, funeral expenses, taxes, and judgments, where the claimant also happens to be the personal representative of the estate. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Cited in Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

§ 28A-19-13. No preference within class.

No personal representative or collector shall give to any claim any preference whatever, either by paying it out of its class or by paying thereon more than a pro rata proportion in its class. (1868-9, c. 113, ss. 25, 26; Code, ss. 1417, 1418; Rev., s. 88; C.S., s. 94; 1973, c. 1329, s. 3.)

CASE NOTES

Prohibition embodied in this section is against the representative. Hence, a solvent person in his lifetime may by his will make preferences in favor of persons who would otherwise be postponed. But, as upon his death his effects and property vest in his representative who must pay the debts first, if the estate is insolvent the representative cannot assent to the payment of preferences before the payment of prior debts as prescribed in the preceding section. The result is that preferences made by an insolvent decedent are rendered ineffective for all purposes. See Moore v. Byers, 65 N.C. 240 (1871), decided under prior law.

Paying by Honest Mistake. — If the representative pays a debt belonging to an inferior class in preference to a superior debt, even though he does it through an honest mistake, he is chargeable for the same. Moye v. Albritton, 42 N.C. 62 (1850), decided under prior law.

§ 28A-19-14. Claims not due rebated.

Claims owed by the estate but not yet due may be paid by the personal representative on a rebate of interest thereon for the time unexpired. (1868-9, c. 113, s. 27; Code, s. 1419; Rev., s. 90; C.S., s. 97; 1973, c. 1329, s. 3.)

§ 28A-19-15. Disputed claim may be referred.

If the personal representative doubts the justness of any claim so presented, he may enter into an agreement, in writing, with the claimant, to refer the matter in controversy, whether the same be of a legal or equitable nature, to one or more disinterested persons, not exceeding three, whose proceedings shall be the same in all respects as if such reference had been ordered in an action. Such agreement to refer, and the award thereupon, shall be filed in the clerk's office where the letters were granted, and shall be a lawful voucher for the personal representative. The same may be impeached in any proceeding against the personal representative for fraud therein: Provided, that the right to refer claims under this section shall extend to claims in favor of the estate as well as those against the estate. (1868-9, c. 113, s. 34; 1872-3, c. 141; Code, s. 1426; Rev., s. 92; C.S., s. 99; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Purpose of Section. — This section was intended to create an expeditious and inexpensive mode by which controversies between executors, administrators or collectors and claimants against the estates of testators and intestates may be settled and determined. State v. Potter, 107 N.C. 415, 12 S.E. 55 (1890); In re Reynolds' Estate, 221 N.C. 449, 20 S.E.2d 348 (1942).

Proceeding authorized by this section is based upon agreement of the parties. It is not an action, nor a consent reference under the Code. It lacks ordinary incidents of a special proceeding which is begun before the clerk. In re Reynolds' Estate, 221 N.C. 449, 20 S.E.2d 348 (1942).

Not Applicable to Creditor's Suit under Former § 28-122. — The proceedings authorized by this section are between a creditor and the personal representative, and had no application to creditor's bill under former G.S. 28-122 instituted to take the administration into the hands of the court. Dunn v. Beaman, 126 N.C. 766, 36 S.E. 172 (1900).

Effect of Agreement to Arbitrate. — An agreement to arbitrate and to award under this section is competent evidence to prove the indebtedness of the estate. Such an agreement is, where there is no fraud or collusion, binding upon the heirs even though they were not parties to the proceedings. Lassiter v. Upchurch, 107 N.C. 411, 12 S.E. 63 (1890).

Finding of Arbitrators as Judgment. — The finding of arbitrators under this section is equivalent to a judgment, and the proceedings in which it is rendered can be impeached only for fraud or collusion. Lassiter v. Upchurch, 107 N.C. 411, 12 S.E. 63 (1890).

Under a fair interpretation of this section, the award of the referees, unless impeached for fraud and collusion, should have at least the effect of determining and putting an end to the controversy, if not the effect of a judgment in an action between the parties. In re Reynolds' Estate, 221 N.C. 449, 20 S.E.2d 348 (1942).

Who May Impeach Result. — Only those having a pecuniary interest in the estate may be heard to impeach the result for collusion or fraud. In re Reynolds' Estate, 221 N.C. 449, 20 S.E.2d 348 (1942).

Appeal. — Where a claimant and the personal representative voluntarily execute a written agreement referring the claim to disinterested persons under this section, the referees are not required to decide the matter according to law, and their report is conclusive and neither party is entitled to appeal therefrom upon exceptions, there being no provisions in this section for appeal, and the proceeding being neither a civil action nor a special proceeding nor a judicial order. In re Reynolds' Estate, 221 N.C. 449, 20 S.E.2d 348 (1942).

Vacation of Reference. — Where clerk appointed a referee to hear claims against the estate of a deceased under this section, and thereafter approved the report of the referee, but on appeal the superior court ruled that the clerk had no authority in the premises and this ruling was unchallenged, such ruling vacated the supposed reference, and ended the matter. In re Shutt, 214 N.C. 684, 200 S.E. 372 (1939).

Effect of Failure to Refer Claim. — Where a claim against an executor is rejected by him in writing and is not referred to in accordance with the provisions of this section, an action thereon is barred under G.S. 28A-19-16 if not brought within six months (now three months) after the rejection of the claim by the executor. Batts v. Batts, 198 N.C. 395, 151 S.E. 868 (1930).

Agreement to Refer Lacking. — Where the executor's letter to claimant merely stated that he "would suggest" that claimant "file a notice of hearing with the Clerk of Court" the language did not show that there was any agreement to refer the matter. In re Estate of Neisen, 114 N.C. App. 82, 440 S.E.2d 855 (1994), cert. denied, 336 N.C. 606, 447 S.E.2d 397 (1994).

§ 28A-19-16. Disputed claim not referred barred in three months.

If a claim is presented to and rejected by the personal representative or collector, and not referred as provided in G.S. 28A-19-15, the claimant must, within three months, after due notice in writing of such rejection, or after some part of the claim becomes due, commence an action for the recovery thereof, or be forever barred from maintaining an action thereon. (1868-9, c. 113, s. 35; Code, s. 1427; Rev., s. 93; 1913, c. 3, s.1; C.S., s. 100; 1961, c. 742; 1973, c. 1329, s. 3.)

Cross References. — As to effect of admission of claim by personal representative upon running of statute of limitations, see G.S. 1-22.

CASE NOTES

Editor's Note. *— Some of the cases below were decided under former Chapter 28 or law prior thereto.*

This statute provides the only procedure for the resolution of a rejected claim. In re Estate of Neisen, 114 N.C. App. 82, 440 S.E.2d 855 (1994), cert. denied, 336 N.C. 606, 447 S.E.2d 397 (1994).

The language of this section is positive and explicit, and the section must be enforced in accordance with the plain meaning of its terms. Morrisey v. Hill, 142 N.C. 355, 55 S.E. 193 (1906); Rutherford v. Harbison, 254 N.C. 236, 118 S.E.2d 540 (1961).

This section applies to creditors' claims against an estate and not to the interests of heirs. The cases construing this Article involve actions by creditors to recover debts. Moreover, G.S. 28A-19-3(h) expressly provides that the word "claim" as used in this Article "does not apply to claims of heirs or devisees to their respective shares or interests in the decedent's estate in their capacity as such heirs or devisees." Poteat v. Robinson, 90 N.C. App. 764, 370 S.E.2d 61 (1988).

Rejection of Claim Must Be Absolute and Unequivocal. — The rejection of a claim against an estate must be absolute and unequivocal in order to start the running of the six months (now three months) statute of limitation. Rutherford v. Harbison, 118 S.E.2d 540 (1961).

Since, when an estate responded to a former wife's claim, it stated that the claim was rejected but offered $ 1,000 in settlement of any claim that she may have had, and invited a response or counter-offer, the former wife could have reasonably inferred that negotiations were in order and a discussion might have resulted in allowance and settlement of the claim in some amount; thus, since the estate failed to absolutely and unequivocally reject the claim, the statute of limitations contained in G.S. 28A-19-16 was not triggered and did not bar the action. Elliott v. Estate of Elliott, 163 N.C. App. 577, 596 S.E.2d 819, 2004 N.C. App. LEXIS 512 (2004), cert. denied, 358 N.C. 731, 601 S.E.2d 530 (2004).

Claim barred under this section cannot be pleaded even by way of counterclaim, in an action by the representative against the claimant, and this regardless of the fact that the general notice provided for in G.S. 28A-14-1 had not been given. Morrisey v. Hill, 142 N.C. 355, 55 S.E. 193 (1906).

Husband's Claim for Funeral Expenses of Wife. — While G.S. 28A-19-6 classified funeral expenses as a debt of the estate, the amount due therefor cannot be regarded as a legacy in this State, and where a husband who has paid the funeral expenses of his wife makes claim therefor upon her executor, and the claim is rejected, and is not referred in accordance with G.S. 28A-19-15, an action on the claim is barred by failure to bring it within six months (now three months) from the time of rejection of the claim by the executor. Batts v. Batts, 198 N.C. 395, 151 S.E. 868 (1930).

A party asserting the right as assignee of an insurance policy to retain the proceeds thereof for obligations he contends were secured by the assignment is not barred, under this section, from asserting such right after the lapse of more than six months (now three months) as against the administrator of the deceased insured in the administrator's action to recover the funds, the defense not constituting a prosecution of a claim against the administrator which had been denied. Sellars v. First Nat'l Bank, 214 N.C. 300, 199 S.E. 266 (1938).

Three Calendar Months Not Equal to 90 Days. — Plaintiff had three calendar months, not 90 days, in which to file an action, thus the trial court erred in dismissing plaintiff's cause of action based on the statute of limitations. Storey v. Hailey, 114 N.C. App. 173, 441 S.E.2d 602 (1994).

Cited in Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979); Gelder & Assocs. v. Huggins, 52 N.C. App. 336, 278 S.E.2d 295 (1981); Kimrey v. Dorsett, 10 Bankr. 466 (Bankr. M.D.N.C. 1981); Blalock v. Dandelake, 90 N.C. App. 461, 368 S.E.2d 891 (1988).

§ 28A-19-17. No lien by suit against representative.

No lien shall be created by the commencement of a suit against a personal representative or collector. (1868-9, c. 113, s. 41; Code, s. 1432; Rev., s. 95; C.S., s. 102; 1973, c. 1329, s. 3.)

§ 28A-19-18. When costs against representative allowed.

No costs shall be recovered in any action against a personal representative or collector unless it appears that payment was unreasonably delayed or neglected, or that the defendant refused to refer the matter in controversy, in which case the court may award such costs against the defendant personally, or against the estate, as may be just. (1868-9, c. 113, s. 38; Code, s. 1429; Rev., s. 97; C.S., s. 103; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *Some of the cases below were decided under former Chapter 28 or law prior thereto.*

The purpose of this section is to urge the representative to an early and prompt settlement of claims against the deceased, and to protect the estate, when proper diligence was used, from cost needlessly incurred by the creditors in prosecuting their claims. May v. Darden, 83 N.C. 237 (1880).

Exception to §§ 6-18 to 6-20. — This section forms an exception to G.S. 6-18 to 6-20, which are general provisions as to cost. Whitaker v. Whitaker, 138 N.C. 205, 50 S.E. 630 (1905). See also Bailey v. Hayman, 222 N.C. 58, 22 S.E.2d 6 (1942).

Not Applicable When Funds Misapplied. — In proceedings to subject a representative to liability for misapplication of the funds, as distinguished from proceedings to recover a debt out of the estate, this section does not apply, and the representative is chargeable with the cost. Valentine v. Britton, 127 N.C. 57, 37 S.E. 74 (1900).

Unreasonable Delay or Neglect. — Where an action was brought within 52 days of the qualification of the administrator, it was held that payment had not been "unreasonably delayed or neglected" within the meaning of this section. Whitaker v. Whitaker, 138 N.C. 205, 50 S.E. 630 (1905). A fortiori the same rule was applied, in May v. Darden, 83 N.C. 237 (1880), when the suit was instituted 20 days after appointment. See also Morris v. Morris, 94 N.C. 613 (1886).

Land Chargeable with Cost. — In proceedings by the creditor to subject the land to the payment of debts, the land is subject to the payment of the cost, wherever the representative can be charged with the cost under the circumstances referred to in this section. Long v. Oxford, 108 N.C. 280, 13 S.E. 112 (1891).

Burden of Proof. — The burden is on the plaintiffs to show that they are entitled to recover costs under this section. Whitaker v. Whitaker, 138 N.C. 205, 50 S.E. 630 (1905).

Appeal. — Although the general rule is that an appeal lies from a judgment for cost only, there is an exception to this rule in favor of fiduciaries, inferred from this section. May v. Darden, 83 N.C. 237 (1880).

Cited in Kimrey v. Dorsett, 10 Bankr. 466 (Bankr. M.D.N.C. 1981).

§ 28A-19-19. Claims for equitable distribution.

(a) The provisions of G.S. 28A-19-5 and G.S. 28A-19-7 shall not apply to claims for equitable distribution.

(b) The personal representative may enter into an agreement, in writing, with a claimant providing for distribution of marital or divisible property, or both, in a manner deemed by the personal representative and the claimant to be equitable. The agreement shall be filed in the clerk's office where the letters were granted and shall be a lawful voucher for the personal representative. The same may be impeached in any proceeding against the personal representative for fraud therein.

(c) Unless the claim for equitable distribution has been referred as provided in G.S. 28A-19-15, the claimant may at anytime, subject to the provisions of G.S. 28A-19-16, file an action with the district court for distribution of marital or divisible property in accordance with the provisions of G.S. 50-20. (2003-168, s. 3.)

Cross References. — As to distribution by court of marital and divisible property, see G.S. 50-20.

ARTICLE 20.

Inventory.

§ 28A-20-1. Inventory within three months.

Every personal representative and collector, within three months after his qualification, shall return to the clerk, on oath, a just, true and perfect inventory of all the real and personal property of the deceased, which have come to his hands, or to the hands of any person for him, which inventory shall be signed by him and be recorded by the clerk. (R.C., c. 46, s. 16; 1868-9, c. 113, s. 8; Code, s. 1396; Rev., s. 42; C.S., s. 48; 1973, c. 1329, s. 3; 1975, c. 300, s. 8.)

CASE NOTES

Editor's Note. — *Most of the cases below were decided under former Chapter 28 or law prior thereto.*

An inventory is but prima facie evidence to charge the executor with assets, so as to call on him for proof to rebut it. Hoover v. Miller, 51 N.C. 79 (1858).

An inventory is prima facie evidence of the solvency of persons owing debts to the estate and described in the inventory. It may be shown that the personal representative made errors in describing and noting the debts. And it seems that the inventory is not evidence against an administrator de bonis non. Grant v. Reese, 94 N.C. 720 (1886).

Statement of Doubtful Debts. — Where an executor returns an inventory of debts without stating that some of the debts are doubtful, he will be held responsible for them, unless he can show that there were setoffs against them, or that the debtors were insolvent. Graham v. Davidson, 22 N.C. 155 (1838).

Where the executor inventories debts as "doubtful," prima facie he will not be chargeable with them. Gay v. Grant, 101 N.C. 206, 8 S.E. 99 (1888), petition to rehear dismissed, 105 N.C. 478, 10 S.E. 891 (1890).

Return of Joint Executors. — Either one of joint executors making a joint return of inventory is answerable for what appears thereon, if it does not show what came to the hand of the other alone. Graham v. Davidson, 22 N.C. 155 (1838).

Transfer of Funds to Another Jurisdiction. — The inventory required by this section must be filed before the transfer of moneys to another jurisdiction. Grant v. Rogers, 94 N.C. 755 (1886).

Representative May Be Compelled to Account or File Inventory. — If the personal representative has failed to file his inventory or his accounts, he can be compelled to do so upon application to the clerk of the superior court. Atkinson v. Ricks, 140 N.C. 418, 53 S.E. 230 (1906).

Failure to Accurately State Value of Account May Constitute Perjury. — The trial court did not err in denying defendant's motion to dismiss charge of perjury concerning 90-day inventory of estate, signed pursuant to this section, where defendant intentionally reported under oath that the "value" of checking account was $27,885, when in reality the checking account contained only $17,885 and the defendant had misappropriated $10,000 by depositing it into his law firm operating account. State v. Linney, 138 N.C. App. 169, 531 S.E.2d 245, 2000 N.C. App. LEXIS 538 (2000).

Failure to File May Bar Commissions. — Failure to file an inventory, coupled with acts of gross negligence and want of care in the management of the estate, was held to deprive the personal representative of his right to commissions. Grant v. Reese, 94 N.C. 720 (1886); Stonestreet v. Frost, 123 N.C. 640, 31 S.E. 836 (1899).

Or Be Grounds for Removal. — Where the executor failed to file the inventory required and was also guilty of other acts of mismanagement it was held that he could be required to give bond or be removed from his office. Barnes v. Brown, 79 N.C. 401 (1878).

§ 28A-20-2. Compelling the inventory.

(a) If the inventory specified in G.S. 28A-20-1 is not filed as prescribed, the clerk of superior court must issue an order requiring the personal representative or collector to file it within the time specified in the order, not less than 20 days, or to show cause why he should not be removed from office. If, after due service of the order, the personal representative or collector does not on or before the return day of the order file such inventory or obtain further time in which to file it, the clerk may remove him from office or may issue an attachment against him for a contempt and commit him until he files said inventory report.

(b) The personal representative or collector shall be personally liable for the costs of any proceeding incident to his failure to file the inventory required by G.S. 28A-20-1. Such costs shall be taxed against him by the clerk of superior court and may be collected by deduction from any commissions which may be found due the personal representative or collector upon final settlement of the estate. (1868-9, c. 113, s. 9; Code, s. 1397; Rev., s. 43; C.S., s. 49; 1929, c. 9, s. 1; 1933, c. 100; 1973, c. 1329, s. 3.)

CASE NOTES

Clerk's Original Jurisdiction. — Under this section the clerk has original jurisdiction to remove the representative for not filing the inventory required. Edwards v. Cobb, 95 N.C. 4 (1886), decided under prior law.

Clerk Has Power to Remove Independent of Statute. — The clerk has power of removal for the failure of the administrator to discharge the duties of his office as prescribed by law. And even without invoking the aid of statute the power of removal is inherent in the office at common law, and must of necessity be so to prevent a failure of justice. Taylor v. Biddle, 71 N.C. 1 (1874), decided under prior law.

§ 28A-20-3. Supplemental inventory.

(a) Whenever any property not included in the original inventory report becomes known to any personal representative or collector or whenever the personal representative or collector learns that the valuation or description of any property or interest therein indicated in the original inventory is erroneous or misleading, he shall prepare and file with the clerk of superior court a supplementary inventory in the same manner as prescribed for the original inventory. The clerk shall record the supplemental report with the original inventory.

(b) The making of the supplemental inventory shall be enforced in a manner specified in G.S. 28A-20-2. (1868-9, c. 113, s. 10; Code, s. 1398; Rev., s. 44; C.S., s. 50; 1973, c. 1329, s. 3.)

§ 28A-20-4. Employment of appraisers.

A personal representative or collector may, but shall not be required to, employ qualified and disinterested appraisers to assist in ascertaining the fair market value as of the date of the decedent's death of any asset the value of which may be subject to reasonable doubt. Different persons may be employed to appraise different kinds of assets. The name and address of any appraiser shall be indicated in the inventory with the asset or assets he appraised. (1973, c. 1329, s. 3.)

Article 21.

Accounting.

§ 28A-21-1. Annual accounts.

Until the final account has been filed pursuant to G.S. 28A-21-2, the personal representative or collector shall, for so long as any of the property of the estate remains in his control, custody or possession, file annually in the office of the clerk of superior court an inventory and account, under oath, of the amount of property received by him, or invested by him, and the manner and nature of such investment, and his receipts and disbursements for the past year. Such accounts shall be due by the fifteenth day of the fourth month after the close of the fiscal year selected by the personal representative or collector, and annually thereafter. The election of a fiscal year shall be made by the personal representative or collector upon filing of the first annual account. In no event may a personal representative or collector select a fiscal year-end which is more than twelve months from the date of death of a decedent or, in the case of trust administration, the date of the opening of the trust. Any fiscal year selected may not be changed without the permission of the clerk of superior court.

The personal representative or collector shall produce vouchers for all payments or verified proof for all payments in lieu of vouchers. The clerk of superior court may examine, under oath, such accounting party, or any other person, concerning the receipts, disbursements or any other matter relating to the estate. He must carefully review and audit such account and, if he approves the account, he must endorse his approval thereon, which shall be prima facie evidence of correctness, and cause the same to be recorded. (C.C.P., s. 478; 1871-2, c. 46; Code, s. 1399; Rev., s. 99; C.S., s. 105; 1957, c. 783, s. 5; 1973, c. 1329, s. 3; 1977, c. 446, s. 1; 1981, c. 955, s. 1; 1987, c. 783, s. 1; 1991, c. 485, s. 1.)

CASE NOTES

Editor's Note. *— Many of the cases below were decided under former Chapter 28 or law prior thereto.*

The word "account" as used in this section means "a statement in writing of debts and credits, or of receipts and payments; a list of items of debts and credits, with their respective dates." It does not include the idea of payment and settlement. State v. Dunn, 134 N.C. 663, 46 S.E. 949 (1904).

Report showing all debts paid except a mortgage indebtedness cannot constitute a final account, since the duties and obligations of administration continue until all debts are paid or all assets exhausted. Creech v. Wilder, 212 N.C. 162, 193 S.E. 281 (1937).

Duty of Clerk to Accept Executor's Annual Account. — Where property is devised or bequeathed by a will, upon certain trusts, and the testator does not appoint a trustee, it is the duty of the executor to carry out the provisions of the will. It was error for the clerk to refuse to accept an annual account tendered by the executor for a year more than two years after the executor qualified but during the life of the trust estate. In re Wachovia Bank & Trust Co., 210 N.C. 385, 186 S.E. 510 (1936). Under § 28A-21-2, the personal representative must now file his final account within one year of his qualification or within six months after his receipt of the State inheritance tax release, whichever is later.

Meaning of "Auditing Accounts". — The provision as to auditing the accounts has reference to the duty of examining the accounts to see that the account of charges corresponds with the inventories, passing upon the vouchers, and striking a balance after allowing commissions. Heilig v. Foard, 64 N.C. 710 (1870).

Jurisdiction for Auditing Accounts Is Ex Parte. — The jurisdiction for auditing accounts conferred upon the clerk by this section is an ex parte jurisdiction of examining the accounts and vouchers of such persons, and does not conclude parties interested or affect suits inter partes upon the same matter. Heilig v. Foard, 64 N.C. 710 (1870); Grant v. Hughes, 94 N.C. 231 (1886); Bean v. Bean, 135 N.C. 92, 47 S.E. 232 (1904).

There is no requirement that a life tenant must account to the court or to a remainderman. Godfrey v. Patrick, 8 N.C. App. 510, 174 S.E.2d 674 (1970).

Account Necessary Before Transferring Funds to Another Jurisdiction. — The administrator in this State of the estate of a nonresident dying in his own state, before transferring the funds to the state of the domicile, must comply with the provisions of this section. Grant v. Rogers, 94 N.C. 755 (1886).

Recorded Account Is Competent Evidence in Collateral Suit. — The account required by this section must be recorded as required in G.S. 2-42 (see now G.S. 7A-109). Such account therefore is not hearsay but is competent evidence in a collateral suit. Braddy v. Pfaff, 210 N.C. 248, 186 S.E. 340 (1936).

Prima Facie Evidence Only. — The sworn account referred to in this section is only prima facie evidence. It is not conclusive as against any person adversely interested. The statute merely shifts the burden of proof. Allen v. Royster, 107 N.C. 278, 12 S.E. 134 (1890); In re Hege, 205 N.C. 625, 172 S.E. 345 (1934); Braddy v. Pfaff, 210 N.C. 248, 186 S.E. 340 (1936).

The representative himself is not estopped to impeach the account. Bean v. Bean, 135 N.C. 92, 47 S.E. 232 (1904).

Cited in Holt v. Lynch, 307 N.C. 234, 297 S.E.2d 594 (1982); Holt v. Lynch, 57 N.C. App. 532, 291 S.E.2d 920 (1982); In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-21-2. Final accounts.

(a) Unless the time for filing the final account has been extended by the clerk of superior court, the personal representative or collector must file the final account for settlement within one year after qualifying or within six months after receiving a State estate or inheritance tax release, whichever is later. If no estate or inheritance tax return was required to be filed for the estate, the personal representative or collector shall so certify in the final account filed with the clerk of superior court. Such certification shall list the amount and value of all of the decedent's property, and with respect to real estate, its particular location within or outside the State, including any property transferred by the decedent over which the decedent had retained any interest, or any property transferred within three years prior to the date of the decedent's death, and after being filed and accepted by the clerk of the superior court shall be prima facie evidence that such property is free of any State inheritance or State estate tax liability. The personal representative or collector shall produce vouchers for all payments or verified proof for all payments in lieu of vouchers. With the approval of the clerk of superior court, such account may be filed voluntarily at any time. In all cases, the accounting shall be reviewed, audited and recorded by the clerk of superior court in the manner prescribed in G.S. 28A-21-1.

(b) Except as provided in subsection (a), after the date specified in the general notice to creditors as provided for in G.S. 28A-14-1, if all of the debts and other claims against the estate of the decedent duly presented and legally owing have been paid in the case of a solvent estate or satisfied pro rata according to applicable statutes in the case of an insolvent estate, the personal representative or collector may file his final account to be reviewed, audited and recorded by the clerk of superior court. Nothing in this subsection shall be construed as limiting the right of the surviving spouse or minor children to file for allowances under G.S. 30-15 through 30-18 and the right of a surviving spouse to file for property rights under G.S. 29-30. (C.C.P., s. 481; Code, s. 1402; Rev., s. 103; C.S., s. 109; 1973, c. 1329, s. 3; 1975, c. 637, s. 5; 1977, c. 446, s. 1; 1979, c. 801, s. 13; 1981, c. 955, s. 2; 1981 (Reg. Sess., 1982), c. 1221, s. 3; 1985, c. 82, s. 3; c. 656, s. 3.1; 1985 (Reg. Sess., 1986), c. 822, s. 3; 1989, c. 770, s. 9; 1999-337, s. 4.)

Editor's Note. — Session Laws 1999-337, s. 46, provides: "This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by this act before the effective date of its amendment or repeal; nor does it affect the right to any refund or credit of a tax that accrued under the amended or repealed statute before the effective date of its amendment or repeal."

Legal Periodicals. — For survey of 1982 law on taxation, see 61 N.C.L. Rev. 1217 (1983).

CASE NOTES

Editor's Note. — *Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Under this section the clerk of the superior court has jurisdiction. McNeill v. Hodges, 105 N.C. 52, 11 S.E. 265 (1890).

Formerly the probate court had jurisdiction to make the representative account. Rowland v. Thompson, 65 N.C. 110 (1871).

Auditing a Judicial Act. — The phrase "audit an account" means something more than the statement of an account by an unauthorized person. It means the act of a court. Hence the auditing under this section must be performed by the clerk, and not by one of his ministerial officers, for a clerk for his judicial functions can have no deputy. Rowland v. Thompson, 65 N.C. 110 (1871).

Filing of Final Account Does Not Discharge Executor. — The removal or discharge of an executor or administrator is not effected by the approval of his final account without a formal order of discharge. Joyner v. Wilson Mem. Hosp., 38 N.C. App. 720, 248 S.E.2d 881 (1978).

Filing of a "final report" by an executor does not have the effect of removing him from office if in fact the estate has not been fully settled, and therefore filing of such a report does not create a vacancy, and does not give the clerk authority to appoint an administrator c.t.a., d.b.n. Edwards v. McLawhorn, 218 N.C. 543, 11 S.E.2d 562 (1940).

Ex Parte Account Presumed Correct. — When ex parte accounts are filed under this section, they are, as a matter of law, to be taken as correct until shown to be erroneous. Turner v. Turner, 104 N.C. 566, 10 S.E. 606 (1889).

Ex Parte Proceeding Works No Estoppel. — The auditing by the clerk, whether under this or under G.S. 28A-21-1, is an ex parte proceeding, and does not work an estoppel upon the parties as a judgment in inter parte proceedings would. In this respect this section and the section just referred to are alike. Bean v. Bean, 135 N.C. 92, 47 S.E. 232 (1904).

Service of Process upon Executrix Prior to Formal Discharge. — Where the executrix had filed her final account but no formal orders of discharge were entered by the clerk of court, the executrix was still empowered to act and service of process upon her was proper in a medical malpractice action. Joyner v. Wilson Mem. Hosp., 38 N.C. App. 720, 248 S.E.2d 881 (1978).

Limitation of Action Against Representative under Former Statute. — See Edwards v. Lemmond, 136 N.C. 329, 48 S.E. 737 (1904).

Review of Order to File Final Account and Turn Over Assets. — Where the clerk orders an executor to file final account and turn over the assets of the trust estate to itself as trustee, which order is made as a matter of law upon the facts found and not as a matter of discretion, the order is reviewable by the superior court upon appeal. In re Wachovia Bank & Trust Co., 210 N.C. 385, 186 S.E. 510 (1936).

Appeal from Audit. — This section, which directs that the probate judge (now the clerk) shall "audit" the account, implies that he shall pursue the usual course which has been found to be just and convenient in such cases. Consequently an appeal may not be had from the decision of the probate judge (now the clerk) upon every question collaterally arising in the course of his investigation, in view of the inconveniences incident to such practice peculiar to the common-law action of account, now superseded by the more expeditious proceedings in equity. Rowland v. Thompson, 64 N.C. 714 (1870).

Cited in Holt v. Lynch, 307 N.C. 234, 297 S.E.2d 594 (1982); Holt v. Lynch, 57 N.C. App. 532, 291 S.E.2d 920 (1982).

§ 28A-21-3. What accounts must contain.

Accounts filed with the clerk of superior court pursuant to G.S. 28A-21-1, signed and under oath, shall contain:

(1) The period which the account covers and whether it is an annual accounting or a final accounting;
(2) The amount and value of the property of the estate according to the inventory and appraisal or according to the next previous accounting, the amount of income and additional property received during the period being accounted for, and all gains from the sale of any property or otherwise;
(3) All payments, charges, losses, and distributions;
(4) The property on hand constituting the balance of the account, if any; and
(5) Such other facts and information determined by the clerk to be necessary to an understanding of the account. (1973, c. 1329, s. 3.)

CASE NOTES

Cited in In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-21-3.1. Phase II tobacco grower and quota owner payments; list of Phase II distributees.

(a) The following definitions apply in this section:

(1) "National Tobacco Grower Settlement Trust" means the trust established by tobacco companies to provide payments to tobacco growers and tobacco quota owners in 14 states for the purposes of ameliorating potential adverse economic consequences of likely reduction in demand, sales, and prices for tobacco as an agricultural product as a result of the Master Settlement Agreement incorporated in the consent decree entered in the action of State of North Carolina vs. Philip Morris, Incorporated, et al., 98 CVS 14377, in the General Court of Justice, Superior Court Division, Wake County, North Carolina.
(2) "Phase II payment" means an amount certified by the North Carolina Phase II Tobacco Certification Entity, Inc., to be paid pursuant to the trust agreement establishing the National Tobacco Grower Settlement Trust.

(b) A personal representative or collector of the estate of a decedent who, during 1993 or any subsequent year, was a tobacco grower or a tobacco quota owner as defined in Section 4.01 of the trust agreement establishing the National Tobacco Grower Settlement Trust may file, along with a final account, a list of Phase II distributees for Phase II payments if all of the following conditions are met:

(1) There are no unsatisfied creditors.
(2) There are no unsatisfied general monetary bequests.

(3) All assets other than any potential Phase II payments have been distributed.

(c) A list of Phase II distributees, signed under oath, must contain the following information:

(1) The name and address of the personal representative or collector.
(2) The name and social security number of the decedent.
(3) The name and address, if known, of each devisee or heir entitled to receive Phase II payments and the percentage of Phase II payments to be received by each.

(d) The clerk of superior court must review the list of Phase II distributees to determine if the list of distributees and their shares of potential Phase II payments are in accordance with the will or, if there is no will, in accordance with the Intestate Succession Act. If the clerk accepts the list of Phase II distributees for filing, the clerk must endorse the clerk's approval thereon, which shall be prima facie evidence of correctness.

(e) Upon determination by the North Carolina Phase II Tobacco Certification Entity, Inc., that the estate of a decedent entitled to any Phase II payment covering a time period when the decedent was alive has been closed, the payment may be paid directly to those distributees and in those shares set forth on a list of Phase II distributees filed under this section without the estate's having to be reopened under G.S. 28A-23-5.

(f) The estate of a decedent who is entitled to any Phase II payment may be reopened, if necessary, in accordance with G.S. 28A-23-5 in order to file a list of Phase II distributees under this section.

(g) For purposes of this section, Phase II payments covering a time period when decedent was alive are deemed cash and shall not pass by virtue of any devise or inheritance of the decedent's real property. (2003-295, s. 2.)

§ 28A-21-4. Clerk may compel account.

If any personal representative or collector fails to account as directed in G.S. 28A-9-3, 28A-21-1 or 28A-21-2 or renders an unsatisfactory account, the clerk of superior court shall, upon his own motion or upon the request of one or more creditors of the decedent or other interested party, promptly order such personal representative or collector to render a full satisfactory account within 20 days after service of the order. If, after due service of the order, the personal representative or collector does not on or before the return day of the order file such account, or obtain further time in which to file it, the clerk may remove him from office or may issue an attachment against him for a contempt and commit him until he files said account. (C.C.P., s. 479; Code, s. 1400; Rev., s. 100; C.S., s. 106; 1933, c. 99; 1973, c. 1329, s. 3.)

CASE NOTES

***Editor's Note.** — Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Original Jurisdiction. — Under this section the clerk has original jurisdiction to remove. Edwards v. Cobb, 95 N.C. 4 (1886).

Jurisdiction over Wrongful Death Proceeds. — Although the trial court found that decedent's wrongful death proceeds were not assets of the estate, the clerk retained authority to oversee the distribution of the proceeds as a result of its power to order an accounting of estate assets, to remove the defendant as the estate's personal representative, to impose sanctions against her based upon alleged misconduct concerning the proceeds, and to order the proceeds submitted to the clerk or public administrator; although wrongful death actions may not yield assets for the estate, a personal representative's authority to commence and settle these actions is "incident to the collection, preservation, liquidation [and] distribution of a decedent's estate." In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Court which appointed fiduciary may, ex mero motu, compel a proper account-

ing by attachment for contempt. Lichtenfels v. North Carolina Nat'l Bank, 260 N.C. 146, 132 S.E.2d 360 (1963).

Or Accounting May Be Compelled by Special Proceedings or Civil Action. — An executor or administrator, as well as a trustee or successor trustee performing duties imposed upon the executors by a testamentary trust, may be compelled to account by special proceedings or civil action, or the court which appointed them may, ex mero motu, compel a proper accounting by attachment for contempt. Lichtenfels v. North Carolina Nat'l Bank, 260 N.C. 146, 132 S.E.2d 360 (1963).

Hearing to Compel Accounting. — Because hearings both to compel accountings and remove personal representative are instituted by notice rather than a formal civil complaint and summons, they are "special proceedings," for which beneficiaries are not required to commence a civil action. In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

Cited in In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804 (1985); Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988).

§ 28A-21-5. Vouchers presumptive evidence.

Vouchers, without other proof, are presumptive evidence of disbursement, unless impeached. If lost, the accounting party must, if required, make oath to that fact setting forth the manner of loss, and state the contents and purport of the voucher. (C.C.P., s. 480; Code, s. 1401; Rev., s. 101; C.S., s. 107; 1973, c. 1329, s. 3.)

CASE NOTES

Editor's Note. — *The cases below were decided under former Chapter 28 or law prior thereto.*

Independent of this section receipts of living persons are not strictly legal evidence to show a full administration. Drake v. Drake, 82 N.C. 443 (1880).

Vouchers Are Presumptive Though Not Primary Evidence. — While this section makes the vouchers presumptive proof, it by no means provides that they shall be primary evidence, and therefore actual payment may still be established in the same way as before the enactment of this section, when the receipts of living persons were not strictly legal evidence to show a full administration. Costen v. McDowell, 107 N.C. 546, 12 S.E. 432 (1890). See Drake v. Drake, 82 N.C. 443 (1880).

What Vouchers Must Show. — This section makes vouchers presumptive evidence of disbursements actually made, but not of their nature and purpose and the necessity for them. To make such vouchers presumptive evidence, they should state with reasonable particularity their purpose, the particular account upon which they were made, the time, etc., so as to make it appear that the expenditure or disbursement was a proper one. McLean v. Breese, 109 N.C. 564, 13 S.E. 910 (1891).

Proof of Handwriting. — The handwriting of the person signing the voucher need be proven only when the voucher is relied on as presumptive evidence under this section. Costen v. McDowell, 107 N.C. 546, 12 S.E. 432 (1890).

Article 22.

Distribution.

§ 28A-22-1. Scheme of distribution; testate and intestate estates.

After the payment of costs of administration, taxes and other valid claims against the decedent's estate, the personal representative shall distribute the remaining assets of the estate in accordance with the terms of decedent's valid probated will or the provisions of Chapter 29 of the General Statutes or as otherwise lawfully authorized. (1973, c. 1329, s. 3.)

CASE NOTES

Cited in Lee v. Barksdale, 83 N.C. App. 368, 350 S.E.2d 508 (1986).

§ 28A-22-2. Shares of after-born and after-adopted children.

The share of an after-born or after-adopted child, as provided by G.S. 29-9 and 31-5.5, shall be allotted to him out of any undevised real or personal property, or out of both, if there is enough such undevised property for that purpose. If there is no undevised real or personal property, or if there is not enough, then the whole of the child's share, or the deficiency, shall be made up from the devised real or personal property, or from both. The portion contributed by a devisee shall bear the same ratio to his devise as the after-born or after-adopted child's share bears to the net estate. (1868-9, c. 113, ss. 108, 109; Code, ss. 1536, 1537; Rev., ss. 138, 139; C.S., ss. 141, 142; 1973, c. 1329, s. 3.)

CASE NOTES

***Editor's Note.** — The cases below were decided under former Chapter 28 or law prior thereto.*

After-Born Child of Intestate Shares in Estate. — This statutory provision clearly assumes and contemplates that an after-born child of an intestate shares in the estate, both real and personal, of such intestate. Byerly v. Tolbert, 250 N.C. 27, 108 S.E.2d 29 (1959).

Child Born to Intestate's Widow More Than 280 Days After His Death. — When it is asserted on behalf of a child born of the woman to whom the intestate was married and with whom he was living at the time of his death that the intestate was her father, the fact that such child was born more than 10 lunar months or 280 days after the intestate's death, standing alone, does not preclude the child as a matter of law from receiving a child's share in the distribution of the intestate's personal estate, absent a statute so providing. Whether such child is the child of intestate is determinable as an issue of fact. Byerly v. Tolbert, 250 N.C. 27, 108 S.E.2d 29 (1959).

If, under all relevant circumstances, a child is born more than 10 lunar months or 280 days after the death of the intestate, the presumption is that the child was not en ventre sa mere when the intestate died. In the absence of evidence to the contrary, this presumption is determinative but this presumption may be rebutted by evidence tending to show that intestate was in fact the father of the child. Thus, when the issue is raised, the burden of proof rests upon such child to establish by the greater weight of the evidence that the intestate was the father. Byerly v. Tolbert, 250 N.C. 27, 108 S.E.2d 29 (1959).

As of What Time Contributions Made. — See Johnson v. Chapman, 54 N.C. 130 (1853).

Child Not en Ventre Sa Mere. — Before a child can be entitled to a distributive share under the statute of distribution, it must appear that he was either in being or en ventre sa mere at the time of the death of the intestate. Thus a half brother of the intestate born 10 and a half months after her death is not entitled to a distributive share, though born before distribution. Grant v. Bustin, 21 N.C. 77 (1835).

§ 28A-22-3. Special proceeding against unknown heirs of decedent before distribution of estate.

If there may be heirs, born or unborn, of the decedent, other than those known to the personal representative and whose names and residences are unknown, before distributing such estate the personal representative is authorized to institute a special proceeding before the clerk of superior court for the purpose of determining who are the heirs of the decedent. All unknown heirs of the decedent shall be made parties thereto and shall be served with summons by publication as provided by G.S. 1A-1, Rule 4. Upon such service being had, the court shall appoint some discreet person to act as guardian ad litem for said unknown heirs and summons shall issue as to such guardian ad litem. Said guardian ad litem shall file answer on behalf of said unknown heirs and he may be paid for his services such sum as the court may fix, to be paid as other costs out of the estate. Upon the filing of the answer by said guardian ad litem all such unknown heirs shall be before the court for the purposes of the proceeding to the same extent as if each had been personally served with summons. Any judgment entered by the court in such proceeding shall be as binding upon said unknown heirs as if they were personally before the court and any payment or distribution made by the personal representative under orders of the court shall have the effect of fully discharging such personal representative and any sureties on his official bond to the full extent of such payment or distribution as ordered. (1957, c. 1248; 1973, c. 1329, s. 3.)

CASE NOTES

The purpose of giving notice by publication is not only to alert the individuals named, but also their friends and acquaintances who may see the publication and give them actual notice. Bank of Wadesboro v. Jordan, 252 N.C. 419, 114 S.E.2d 82 (1960), decided under prior law.

Strict Compliance Required. — Service by publication is in derogation of the common law and strict compliance is required. Bank of Wadesboro v. Jordan, 252 N.C. 419, 114 S.E.2d 82 (1960), decided under prior law.

Heirs have a right to be heard before the court decrees they are precluded from sharing in the estate of decedent who dies intestate, and are entitled to such notice of the hearing as the law provides, which may be by proper publication in the event personal service cannot be had. Bank of Wadesboro v. Jordan, 252 N.C. 419, 114 S.E.2d 82 (1960), decided under prior law.

Sufficiency of Notice. — Notice merely to known and unknown heirs is insufficient if more definite identification is available. Bank of Wadesboro v. Jordan, 252 N.C. 419, 114 S.E.2d 82 (1960), decided under prior law.

Cited in Ladd v. Estate of Kellenberger, 64 N.C. App. 471, 307 S.E.2d 850 (1983).

§ 28A-22-4. Distribution to nonresident trustee only upon appointment of process agent.

(a) No assets of the estate of a decedent subject to administration in this State shall be delivered or transferred to a trustee of a testamentary trust or an inter vivos trust who is a nonresident of this State who has not appointed a resident agent for the service of civil process for actions or proceedings arising out of the administration of the trust with regard to such property.

(b) If property is delivered or transferred to a trustee in violation of this section, process may be served outside this State or by publication, as provided by G.S. 1A-1, Rule 4, and the courts of this State shall have the same jurisdiction over the trustee as might have been obtained by service upon a properly appointed process agent. The provisions of this section with regard to jurisdiction shall be in addition to other means of obtaining jurisdiction permissible under the laws of this State. (1967, c. 947; 1973, c. 1329, s. 3.)

§ 28A-22-5. Distribution of assets in kind in satisfaction of bequests and transfers in trust.

(a) Subject to the provisions of subsection (b) of this section, whenever under any will or trust indenture the executor, trustee or other fiduciary is required to, or has an option to, satisfy a bequest or transfer in trust by a transfer of assets of the estate or trust in kind at the values as finally determined for federal estate tax purposes, the executor, trustee or other fiduciary shall, in the absence of contrary provisions in such will or trust indenture, be required to satisfy such bequest or transfer by the distribution of assets fairly representative of the appreciation or depreciation in the value of all property available for distribution in satisfaction of such bequest or transfer.

(b) The provisions of subsection (a) of this section shall not apply unless either:

(1) The decedent's surviving spouse is the beneficiary of the bequest or trust transfer described in subsection (a) of this section or of the residue of the estate or trust; or

(2) Any "skip person", as that term is defined in Chapter 13 of the Internal Revenue Code of 1986, as amended, is or may be a current or future beneficiary of the bequest or trust transfer described in subsection (a) of this section or of the residue of the estate or trust, and the value of the decedent's gross estate for federal tax purposes exceeds the value of the decedent's unused generation-skipping tax exemption available under Chapter 13 of the Internal Revenue Code of 1986, as amended. (1965, c. 764, s. 1; 1973, c. 1329, s. 3; 1995, c. 235, s. 5.)

§ 28A-22-6. Agreements with taxing authorities to secure benefit of federal marital deduction.

The executor, trustee, or other fiduciary having discretionary powers under a will or trust indenture with respect to the selection of assets to be distributed in satisfaction of a bequest or transfer in trust to or for the benefit of the surviving spouse of a decedent shall be authorized to enter into agreements with the Commissioner of Internal Revenue of the United States of America, and other taxing authorities, requiring the fiduciary to exercise the fiduciary's discretion so that cash and other properties distributed in satisfaction of such bequest or transfer in trust will be fairly representative of the net appreciation or depreciation in value on the date, or dates, of distribution of all property then available for distribution in satisfaction of such bequest or transfer in trust. Any such fiduciary shall be authorized to enter into any other agreement not in conflict with the express terms of the will or trust indenture that may be necessary or advisable in order to secure for federal estate tax purposes the appropriate marital deduction available under the Internal Revenue Laws of the United States of America and to do and perform all acts incident to such purpose. (1965, c. 744; 1973, c. 1329, s. 3.)

§ 28A-22-7. Distribution to parent or guardian of a minor.

(a) If a devise or legacy of personal property to a person under the age of 18 has a total value of less than one thousand five hundred dollars ($1,500), and the devisee or legatee is residing in the same household with a parent or a guardian appointed prior to the decedent's death, the personal representative may distribute to the parent or guardian the devise or legacy. However, such distribution shall only be made with the prior approval of the clerk of court who issued the letters testamentary or of administration.

(b) If such distribution has been made the parent or guardian shall use the property solely for the education, maintenance and support of the devisee or legatee. However, the parent or guardian shall not be required to file an accounting with the clerk of court or to the personal representative, nor shall such distribution be cause for a delay in the filing of the personal representative's final account under the provisions of Article 21 of this Chapter.

(c) This section establishes a procedure that is separate from the provisions of G.S. 33-69.1 and it is not the intention of this section to repeal in whole or in part the provisions of G.S. 33-69.1.

(d) This section may also be applied to several devises or legacies of personal property to a single devisee or legatee having a combined total value of less than one thousand five hundred dollars ($1,500). (1975, c. 813, s. 1.)

Editor's Note. — Section 33-69.1, referred to in this section, has been repealed. For the North Carolina Uniform Transfers to Minors Act, see now G.S. 33A-1 et seq.

§ 28A-22-8. Executor or trustee; discretion over distributions.

Unless otherwise restricted by the terms of the will or trust, an executor or trustee shall have absolute discretion to make distributions in cash or in specific property, real or personal, or an undivided interest therein or partly in cash or partly in such property, and to do so without regard to the income tax basis for federal tax purposes of specific property allocated to any beneficiary. (1977, c. 740.)

§ 28A-22-9. Distribution to known but unlocated devisees or heirs.

(a) If there are known but unlocated devisees or heirs of property held by the personal representative, the personal representative may deliver the share of such devisee or heir to the clerk of superior court immediately prior to filing of the final account. If the devisee or heir is located after the final account has been filed, he may present a claim for the share to the clerk. If the clerk determines that the claimant is entitled to the share, he shall deliver the share to the devisee or claimant. If the clerk denies the claim, the claimant may take an appeal as in a special proceeding.

(b) The clerk shall hold the share without liability for profit or interest. If no claim has been presented within a period of one year after the filing of the final account, the clerk shall deliver the share to the State Treasurer as abandoned property.

(c) The clerk shall not be required to publish any notice to such devisee or heir and shall not be required to report such share to the State Treasurer. If the devisee or heir is located, the clerk shall inform the devisee or heir that he is entitled to file a claim with the State Treasurer for the share under the provisions of G.S. 116B-67. (1979, 2nd Sess., c. 1311, s. 2; 2002-62, s. 1.)

Editor's Note. — Section 116B-38(a), referred to in subsection (c) above, has been repealed. See now G.S. 116B-67(a), (b).

Legal Periodicals. — For survey of 1980 property law, see 59 N.C.L. Rev. 1209 (1981).

§ 28A-22-10. Distribution of assets of inoperative trust.

When the facts at the time of distribution of property to a trust are such that the trust would be inoperative under the terms of the instrument creating the trust for any reason, including the death of a beneficiary, renunciation by a beneficiary, the exercise of a right to withdraw the property by a beneficiary, or the attainment of a stipulated age by a beneficiary, the personal representative or the trustee authorized or required to make the distribution of that property to the trust may distribute the property directly to the person or persons entitled to it under the terms of the instrument creating the trust without the interposition of the establishment of the trust. If only a portion of the trust would be inoperative, the property distributable to that portion of the trust may be distributed directly to the person or persons entitled to the property under the terms of the instrument creating the trust. (2001-413, s. 3.)

ARTICLE 23.

Settlement.

§ 28A-23-1. Settlement after final account filed.

When the personal representative or collector has paid or otherwise satisfied or provided for all claims against the estate, has distributed the remainder of the estate pursuant to G.S. 28A-22-1 and has filed his final account for settlement pursuant to G.S. 28A-21-2, if the clerk of superior court, after review of the personal representative's or collector's final account, approves the same, he shall enter an order discharging the personal representative or collector from further liability. (1973, c. 1329, s. 3; 1977, c. 446, s. 1.)

CASE NOTES

Applied in In re Watson, 70 N.C. App. 120, 318 S.E.2d 544 (1984).

Cited in In re Estate of Heffner, 61 N.C. App. 646, 301 S.E.2d 720 (1983).

§ 28A-23-2. Payment into court of fund due minor.

When any personal representative or collector holds property due a minor without a guardian and desires to file his petition for settlement, he may deliver the property to the clerk of superior court who shall invest upon interest or otherwise manage said property for the use of the minor or the clerk may proceed to appoint a guardian for the minor pursuant to the provisions of Chapter 35A of the General Statutes and then may deliver the property of the minor to the guardian. (1868-9, c. 113, s. 97; Code, s. 1526; 1893, c. 317; Rev., s. 151; C.S., s. 153; 1965, c. 815, s. 3; 1973, c. 1329, s. 3; 1987, c. 550, s. 17.)

Cross References. — As to the manner of investment of funds in the hands of clerks of court under color of their office, see G.S. 7A-112.

§ 28A-23-3. Commissions allowed personal representatives; representatives guilty of misconduct or default.

(a) Personal representatives, collectors or public administrators shall be entitled to commissions to be fixed in the discretion of the clerk of superior court not to exceed five percent (5%) upon the amounts of receipts, including the value of all personal property when received, and upon the expenditures made in accordance with law. In determining the maximum commissions allowable under this subsection, the clerk of superior court may take into consideration fees paid by the estate for professional services performed in the ordinary course of administering the estate, including services performed by attorneys and accountants. However, the clerk is not required to reduce the maximum commissions allowed by the aggregate fees paid to professionals on a dollar-for-dollar basis.

The commissions shall be charged as a part of the costs of administration and, upon allowance, may be retained out of the assets of the estate against creditors and all other persons claiming an interest in the estate. If the gross value of an estate is two thousand dollars ($2,000) or less, the clerk of superior court may fix the commission to be received by the personal representative, collector or public administrator in an amount the clerk of superior court, in the clerk's discretion, deems just and adequate.

(b) In determining the amount of the commissions, both upon personal property received and upon expenditures made, the clerk of superior court shall consider the time, responsibility, trouble and skill involved in the management of the estate. Where real property is sold to pay debts or legacies, the commission shall be computed only on the proceeds actually applied in the payment of debts or legacies.

(c) The clerk of superior court may allow commissions from time to time during the course of the administration, but the total commissions allowed shall be determined on final settlement of the estate and shall not exceed the limit fixed in this section.

(d) Nothing in this section shall be construed to:

(1) Prevent the clerk of the superior court from allowing reasonable sums for necessary charges and disbursements incurred in the management of the estate.

(2) Allow commissions on distribution of the shares of heirs or on distribution of shares of devisees.

(3) Abridge the right of any party interested in the administration of a decedent's estate to appeal an order of the clerk of superior court to a judge of superior court.

(e) No personal representative, collector or public administrator, who has been guilty of default or misconduct in the due execution of his or her office resulting in the revocation of his or her appointment of the personal representative, collector, or public administrator under the provisions of G.S. 28A-9-1, shall be entitled to any commission under the provisions of this section.

(f) For the purpose of computing commissions whenever any portion of the dividends, interest, rents or other amounts payable to a personal representative, collector or public administrator is required by any law of the United States or other governmental unit to be withheld for income tax purposes by the person, corporation, organization or governmental unit paying the same, the amount withheld shall be deemed to have been received and expended.

(g) Subsection (a) of this section does not apply if the testator's will specifies a stipulated amount or method or standard for determining the compensation for the services rendered by the personal representative, including a provision in the will that the compensation of the personal representative is to be determined by applying the personal representative's regularly adopted schedule of compensation in effect at the time of performance of those services. Subsection (a) of this section also shall not apply if the testator's will provides that the personal representative is to receive "reasonable compensation" for those services or similar language to that effect if the personal representative and the beneficiaries whose shares would be charged with the payment of the personal representative's compensation consent in writing to the specific amount that constitutes reasonable compensation.

(h) Subsection (a) of this section shall apply if the testator's will provides that compensation of the personal representative shall be the amount "as provided by law," the "maximum amount provided by law," or other similar language. (1868-9, c. 113, s. 95; 1869-70, c. 189; Code, s. 1524; Rev., s. 149; C.S., s. 157; 1941, c. 124; 1953, c. 855; 1959, c. 662; c. 879, s. 8; 1961, cc. 362, 575; 1973, c. 1329, s. 3; 1977, c. 814, s. 2; 2005-388, s. 1.)

Effect of Amendments. — Session Laws 2005-388, s. 1, effective January 1, 2006, and applicable to commissions paid on or after that date, rewrote subsection (a); in subsection (b), substituted "the commissions" for "such commissions" in the first sentence; in subsection (e), deleted "such" preceding "default" and inserted "or her" following "of his" twice and "of the personal representative, collector, or public administrator"; added subsections (g) and (h); and made minor punctuation and stylistic changes.

CASE NOTES

***Editor's Note.** — Many of the cases below were decided under former Chapter 28 or law prior thereto.*

Purpose of Subsection (b). — Subsection (b) of this section ensures that the personal representative's commission on a sale of real estate is limited to the amount that was actually needed for the payment of claims. This discourages personal representatives from selling land merely to increase their commissions. Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988), aff'd, 324 N.C. 541, 379 S.E.2d 857 (1989).

Authority of Clerks of Court Where Representative Qualifies. — The clerk of the superior court where the personal representative qualifies has authority to fix the amount of fees to which an executor or administrator is entitled. Strickland v. Jackson, 259 N.C. 81, 130 S.E.2d 22 (1963).

Discretion of Clerk. — The allowance of commissions, by way of compensation, to an executor requires the exercise of judicial discretion and judgment by the clerk of the superior court. It is he who has original jurisdiction. If any interested party conceives that the allowance made by him is either inadequate or excessive, or is made under an erroneous conception of the law, he may appeal. But the Supreme Court, upon review of the compensation allowed, cannot perform the function of the clerk, for it has no original jurisdiction in such matters. Wachovia Bank & Trust Co. v. Waddell, 237 N.C. 342, 75 S.E.2d 151 (1953).

Commissions of an administrator of the estate of a decedent are to be fixed in the discretion of the clerk of superior court subject to the maximum provided by statute. This requires exercise of judicial discretion and judgment by the clerk, who has original jurisdiction in the matter. In re Green, 9 N.C. App. 326, 176 S.E.2d 19 (1970).

The allowance of a commission to an executor is a matter within the original jurisdiction of the clerk of the superior court and it is within his discretion to fix the amount, subject to the maximum provided by statute. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

An executor has no right to fix and determine compensation to be received by him. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

It is necessary for the executor to file a petition for commissions and fees along with the annual accountings to enable the clerk to determine the amount of the commission and attorneys' fees. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Section Controls in Absence of Testamentary Provision. — In the absence of an effective testamentary provision on the subject, the right of the personal representative of a decedent to compensation is controlled by this section. In re Ledbetter, 235 N.C. 642, 70 S.E.2d 667 (1952).

A testator may stipulate in his will the compensation to be paid the person appointed executor with power to settle his estate. When this is done the provisions of the will are binding on all interested parties. But an executor has no right to fix and determine the compensation to be received by him. Wachovia Bank & Trust Co. v. Waddell, 237 N.C. 342, 75 S.E.2d 151 (1953).

Ordinarily, where the will expressly stipulates the compensation to be allowed an executor, the executor, by qualifying, is deemed to have accepted a bargain and is bound thereby even though the will stipulates compensation in a sum less than the five percent maximum allowed by statute. Wachovia Bank & Trust Co. v. Morgan, 279 N.C. 265, 182 S.E.2d 356 (1971).

Maximum Percentage Set by Will Controls. — Where the will does not fix or purport to fix the compensation to be paid testator's executor as compensation for services in settling his estate, but merely fixes the maximum percentage on receipts and disbursements at two and a half percent, it is the duty of the clerk to make an allowance to the executor subject to the maximum limitation stipulated in the will rather than the maximum fixed by this section. Wachovia Bank & Trust Co. v. Waddell, 237 N.C. 342, 75 S.E.2d 151 (1953).

The terms "receipts" and "expenditures," as used in this section, refer to the actual receipts and the actual expenditures of the personal representative. An administrator has no lawful claim to commissions on the credits or offsets deducted by a consent judgment from the indebtedness of his testate. This is so for the reason that the deductions were neither actually received nor actually expended by the administrator. In re Ledbetter, 235 N.C. 642, 70 S.E.2d 667 (1952).

Dower as an "Interest in the Estate". — Manifestly, a claim of dower is an "interest" in the estate. Hence the wording of this section lends direct support to a judgment giving priority to commissions due executors, reasonable attorneys' fees and costs. Parsons v. Leak, 204 N.C. 86, 167 S.E. 563 (1933).

Representative Must Discharge Duties. — The representative is not, under this section, entitled to commission at all events. He must have earned them by a just and reasonable discharge of his duties. It must appear that the "receipts and expenditures" referred to have been fairly made in the course of administration. The law will not allow compensation to one who disregards its commands. Grant v. Reese, 94 N.C. 720 (1886).

When Commissions and Charges Should Not Be Allowed. — The compensation is allowed to the representative in order to reward him not only for his time, labor and trouble but also for the responsibility incurred, and the fidelity with which he discharged the duties of his trust. It should not be allowed where due to his neglect the estate has suffered loss. Kelly v. Odum, 139 N.C. 278, 51 S.E. 953 (1905).

Same — Allowance of necessary charges and disbursements, such as counsel fees. See Kelly v. Odum, 139 N.C. 278, 51 S.E. 953 (1905); Johnson v. Marcom, 121 N.C. 83, 28 S.E. 58 (1897).

Commissions are allowed where one person is both administrator and guardian of distributee. Rose v. Bank of Wadesboro, 217 N.C. 600, 9 S.E.2d 2 (1940).

Commission on Both Receipts and Disbursements. — Commissions may be allowed to the representative on both receipts and disbursements, as separate acts. Battery Park Bank v. Western Carolina Bank, 126 N.C. 531, 36 S.E. 39 (1900).

Section Does Not Affect Powers of Clerk as to Fees of Commissioners. — This section does not divest the clerk of the superior court of the powers and duties expressly committed to him by the provisions of G.S. 1-408 with respect to the fees of commissioners appointed for the sale of land as provided therein. Welch v. Kearns, 259 N.C. 367, 130 S.E.2d 634 (1963).

Attorney as Executor. — When a lawyer voluntarily becomes executor he assumes the office cum onere, and the exercise by him of his professional skill in the management of the estate does not entitle him to counsel fees, but his compensation is limited to the five percent maximum allowed by this section. Lightner v. Boone, 221 N.C. 78, 19 S.E.2d 144 (1942).

Trustee May Purchase Special Skills. — Where special skills are required, a trustee is entitled to purchase such skills at the expense of the trust estate in order to accomplish the trust purpose. Wachovia Bank & Trust Co. v. Morgan, 279 N.C. 265, 182 S.E.2d 356 (1971).

Where the trust income could best be applied to meet the charitable purposes through the advice of an advisory board assisted by a full-time director, and without such assistance the trust would be lacking in adequate direction the trial court correctly allowed the trustees to employ skilled assistance in the administration of the trust and to charge the reasonable cost for such assistance to trust income. Wachovia Bank & Trust Co. v. Morgan, 279 N.C. 265, 182 S.E.2d 356 (1971).

Necessary Charges, Such as Counsel Fees, Allowed. — Besides commissions, the representative is allowed to retain his expenses for necessary charges and disbursements in the settlement of the estate. Among these necessary charges fees paid to counsel are embraced. Hester v. Hester, 38 N.C. 9 (1843); Love v. Love, 40 N.C. 201 (1848); Fairbairn v. Fisher, 58 N.C. 385 (1860).

A reasonable fee for legal advice and assistance in the management of a trust estate is allowable as a necessary expense of the trust estate. Tripp v. Tripp, 17 N.C. App. 64, 193 S.E.2d 366 (1972).

Payment of Commissions Held Proper. — Commissions to the executor of an estate could be paid on proceeds from the sale of real estate where the executor was required to sell the property under the terms of the will and the property was not sold to pay debts or legacies. Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988), aff'd, 324 N.C. 541, 379 S.E.2d 857 (1989).

Commission Improperly Calculated. — Since a guardian sold properties specifically to pay the debts and administrative costs of the guardianship estate, an award of commissions to the guardian based upon a percentage of the total proceeds of the sales was improper; G.S. 28A-23-3(b) unambiguously limited the commissions under such circumstances to a percentage of only the amount of proceeds used to pay such costs and debts. In re Estate of Moore, 160 N.C. App. 85, 584 S.E.2d 807, 2003 N.C. App. LEXIS 1664 (2003).

Advance Held Improper. — Because the clerk alone has the discretion to fix an executor's compensation and an attorneys' fee, coexecutor's advance to himself of the sum of $32,950.00 from the estate was improper. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Order for Commissions Final Judgment. — An order allowing commissions is a final judgment upon which an appeal may be taken. Battery Park Bank v. Western Carolina Bank, 126 N.C. 531, 36 S.E. 39 (1900).

Appeal on Commission under Five Percent. — Notwithstanding the fact that the amount of commissions allowed in a given case has not exceeded five percent on the receipts and disbursements, the allowance is reviewable upon appeal for inadequacy or excessiveness. It cannot strictly be said that the lower court has exclusive discretion within the limit of five percent. Battery Park Bank v. Western Carolina Bank, 126 N.C. 531, 36 S.E. 39 (1900).

Cited in Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979); In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C.

App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001).

§ 28A-23-4. Counsel fees allowable to attorneys serving as representatives.

The clerk of superior court, in his discretion, is authorized and empowered to allow counsel fees to an attorney serving as a personal representative, collector or public administrator (in addition to the commissions allowed him as such representative, collector or public administrator) where such attorney in behalf of the estate he represents renders professional services, as an attorney, which are beyond the ordinary routine of administration and of a type which would reasonably justify the retention of legal counsel by any such representative, collector or public administrator not himself licensed to practice law. (1957, c. 375; 1973, c. 1329, s. 3; 1977, c. 814, s. 3.)

Legal Periodicals. — For article on the continuing power of attorney, see 5 Campbell L. Rev. 305 (1983).

CASE NOTES

Fees awarded under this section should be for actual services rendered and should not be based solely upon the size of the estate; nevertheless, the size of the estate provides a useful guideline and may be considered as a factor in determining whether legal services were necessary and the time expended justified. Matthews v. Watkins, 91 N.C. App. 640, 373 S.E.2d 133 (1988), aff'd, 324 N.C. 541, 379 S.E.2d 857 (1989).

Advance Held Improper. — Because the clerk alone has the discretion to fix an executor's compensation and an attorneys' fee, coexecutor's advance to himself of the sum of $32,950.00 from the estate was improper. In re Estate of Longest, 74 N.C. App. 386, 328 S.E.2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E.2d 488 (1985).

Cited in In re Lessard, 78 N.C. App. 196, 336 S.E.2d 712 (1985); In re Estate of Parrish, 143 N.C. App. 244, 547 S.E.2d 74, 2001 N.C. App. LEXIS 272 (2001), cert. denied, 354 N.C. 69, 553 S.E.2d 201 (2001); In re Estate of Moore, 160 N.C. App. 85, 584 S.E.2d 807, 2003 N.C. App. LEXIS 1664 (2003).

§ 28A-23-5. Reopening administration.

If, after an estate has been settled and the personal representative discharged, other property of the estate shall be discovered, or if it shall appear that any necessary act remains unperformed on the part of the personal representative, or for any other proper cause, the clerk of superior court, upon the petition of any person interested in the estate and without notice or upon such notice as he may direct, may order that said estate be reopened. He may reappoint the personal representative or appoint another personal representative to administer such property or perform such acts as may be deemed necessary. Unless the clerk of superior court shall otherwise order, the provisions of this Chapter as to an original administration shall apply to the proceedings had in the reopened administration; but no claim which is already barred can be asserted in the reopened administration. (1973, c. 1329, s. 3.)

CASE NOTES

"Proper Cause" to Reopen. — The existence of a valid claim against an estate which is not time-barred may, in an appropriate case, constitute "proper cause" to reopen a closed estate in order to assert the claim. However, claims which are already barred may not be asserted in a reopened administration. Thus, without more, a claim which is barred by the statute of limitations may not constitute "proper cause" to reopen administration of a closed estate. In re Estate of English, 83 N.C. App. 359, 350 S.E.2d 379 (1986), cert. denied, 319 N.C. 403, 354 S.E.2d 711 (1987).

Reopening of Estate After Six-Month Period. — The provision in this section prohibiting any claim which is already barred from being asserted in the reopened estate primarily refers to the limitations in G.S. 28A-19-3 on the presentation of claims. Thus, an estate may not ordinarily be reopened for the litigation of claims not brought within the six-month period, even in the absence of a bar by some other statute of limitations. In re Estate of English, 83 N.C. App. 359, 350 S.E.2d 379 (1986), cert. denied, 319 N.C. 403, 354 S.E.2d 711 (1987).

Order Setting Aside Prior Order Reopening Estate Was Proper. — Ultimate fact before the clerk was whether a testator's estate would remain closed, and the clerk's order, which made a specific finding on this ultimate fact by stating that a prior order reopening the subject estate was improvidently and inappropriately entered, that the same should have been and was therefore set aside, and that the estate was to remain closed, complied with the requirements of G.S. 1-301.3(b). In re Estate of Mullins, — N.C. App. —, 643 S.E.2d 599, 2007 N.C. App. LEXIS 798 (2007).

Refusal of Clerk to Reopen Estate Upheld. — In light of the public policy in favor of the expedited administration of estates, as evidenced by the six-month statute of limitations and other provisions of this Chapter, petitioner who alleged that the deceased had promised to devise a life estate to her had a heavy burden of justifying her failure to bring her suit within the six-month period provided for that purpose, or at the very least, within the greater than two-year period that the estate actually remained open. There was no error in the clerk's determination that this burden was not met. In re Estate of English, 83 N.C. App. 359, 350 S.E.2d 379 (1986), cert. denied, 319 N.C. 403, 354 S.E.2d 711 (1987).

ARTICLE 24.

120-Hour Survivorship Requirement; Revised Simultaneous Death Act.

§ 28A-24-1. Definitions.

In this Article:

(1) "Co-owners with right of survivorship" includes joint tenants in a joint tenancy with right of survivorship, tenants by the entireties, and other co-owners of property or accounts held under circumstances that entitle one or more to the whole of the property or account on the death of the other or others.

(2) "Governing instrument" means a deed, will, trust, insurance or annuity policy, account with a POD designation, pension, profit sharing, retirement, or similar benefit plan, instrument creating or exercising a power of appointment or a power of attorney, or a dispositive, appointive, or nominative instrument of any similar type.

(3) "Payor" means a trustee, insurer, business entity, employer, government, governmental agency or subdivision, or any other person authorized or obligated by law or a governing instrument to make payments. (1947, c. 1016, s. 1; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Editor's Note. — Session Laws 2007-132, s. 1, rewrote Article 24 of Chapter 28A. The historical citations to former sections have been retained for research purposes.

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-2. Requirement of survival by 120 hours.

(a) Except as otherwise provided in this Article, where the title to property, the devolution of property, the right to elect an interest in property, or any other right or benefit depends upon an individual's survivorship of the death of another individual, an individual who is not established by clear and convincing evidence to have survived the other individual by at least 120 hours is deemed to have predeceased the other individual.

(b) If the language of the governing instrument disposes of property in such a way that two or more beneficiaries are designated to take alternatively by reason of surviving each other and it is not established by clear and convincing evidence that any such beneficiary has survived any other such beneficiary by at least 120 hours, the property shall be divided into as many equal shares as there are alternative beneficiaries, and these shares shall be distributed respectively to each such beneficiary's estate.

(c) If the language of the governing instrument disposes of property in such a way that it is to be distributed to the member or members of a class who survived an individual, each member of the class will be deemed to have survived that individual by at least 120 hours unless it is established by clear and convincing evidence that the individual survived the class member or members by at least 120 hours. (1947, c. 1016, s. 2; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-3. Co-owners with right of survivorship; requirement of survival by 120 hours.

Except as otherwise provided in this Article, (i) if it is not established by clear and convincing evidence that one of two co-owners with right of survivorship survived the other co-owner by at least 120 hours, one-half of the property passes as if one had survived by at least 120 hours and one-half as if the other had survived by at least 120 hours and (ii) if there are more than two co-owners with right of survivorship and it is not established by clear and convincing evidence that at least one of them survived the others by at least 120 hours, the property passes to the estates of each of the co-owners in the proportion that one bears to the whole number of co-owners. (1947, c. 1016, s. 3; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-4. Survival of an event; 120-hour period not applicable.

For purposes of a governing instrument that requires survival of an event, other than the death of another individual, the 120-hour survivorship requirement of this Article does not apply. (1947, c. 1016, s. 4; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-5. Victim deemed to survive slayer.

Notwithstanding any other provisions of this Article, solely for the purpose of determining whether the victim is entitled to any right or benefit that depends on surviving the death of a slayer under G.S. 31A-3, the slayer is deemed to have predeceased the victim and the victim is deemed to have survived the slayer by at least 120 hours (or any greater survival period required of the victim under the slayer's will or other governing instrument) unless it is established by clear and convincing evidence that the slayer survived the victim by at least 120 hours. (1947, c. 1016, s. 6; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-6. Exceptions to the 120-hour survival requirement.

Survival by 120 hours is not required if any of the following apply:

(1) The governing instrument contains language dealing explicitly with simultaneous deaths or deaths in a common disaster and the language is operable under the facts of the case.

(2) The governing instrument expressly indicates that an individual is not required to survive the death of another individual by any specified period or expressly requires the individual to survive another individual for a specified period; but survival must be established by clear and convincing evidence.

(3) The imposition of a 120-hour requirement of survival would cause a nonvested property interest or a power of appointment to fail to qualify for validity under G.S. 41-15; but survival must be established by clear and convincing evidence.

(4) The application of a 120-hour requirement of survival to multiple governing instruments would result in an unintended failure or duplication of a disposition; but survival must be established by clear and convincing evidence.

(5) The application of a 120-hour requirement of survival would deprive an individual or the estate of an individual of an otherwise available tax exemption, deduction or credit, expressly including the marital deduction, resulting in the imposition of a tax upon a donor or testator or other person (or their estate) as the transferor of any property. "Tax" includes any federal or State gift, estate or inheritance tax.

(6) The application of a 120-hour requirement of survival would result in an escheat. (1947, c. 1016, s. 7; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-7. Evidence of death or status.

For purposes of this Article, the following rules of evidence apply relating to the determination of death and status of a beneficiary subject to a requirement of survivorship and of the person the beneficiary must survive:

(1) Death occurs when an individual is determined to be dead pursuant to G.S. 90-323 or Chapter 28C of the General Statutes.

(2) A certified or authenticated copy of a death certificate purporting to be issued by an official or agency in the place where the death purportedly occurred is prima facie evidence of the fact, place, date, and time of death and the identity of the decedent. In the absence of evidence disputing the death certificate, that certificate shall be conclusive

evidence of the fact, place, date, and time of death and the identity of the decedent.

(3) A certified or authenticated copy of any record or report of a governmental agency, domestic or foreign, that an individual is missing, detained, dead, or alive is prima facie evidence of the status and of the dates, circumstances, and places disclosed by the record or report. The record or report is conclusive evidence of the status and of the dates, circumstances, and places disclosed by the record or report unless there is evidence to the contrary.

(4) In the absence of prima facie evidence of death under subdivision (2) or (3) of this section, the fact of death may be established by clear and convincing evidence, including circumstantial evidence. (1947, c. 1016, s. 8; 1973, c. 1329, s. 3; 2007-132, s. 1.)

Effect of Amendments. — Session Laws 2007-132, s. 1, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, rewrote this Article.

§ 28A-24-8. Protection of payors, bona fide purchasers, and other third parties; personal liability of recipient.

(a) A payor or other third party is not liable for having made a payment or transferred an item of property or any other benefit to a person designated in a governing instrument who, under this Article, is not entitled to the payment or item of property, or for having taken any other action in good faith reliance on the person's apparent entitlement under the terms of the governing instrument, before the payor or other third party received written notice of a claimed lack of entitlement under this Article. A payor or other third party is liable for a payment made or other action taken after the payor or other third party received written notice of a claimed lack of entitlement under this Article.

Written notice of a claimed lack of entitlement under this Article must be mailed to the payor's or other third party's main office or home by registered or certified mail, return receipt requested, or served upon the payor or other third party in the same manner as a summons in a civil action. Upon receipt of written notice of a claimed lack of entitlement under this Article, a payor or other third party may pay any amount owed or transfer or deposit any item of property other than tangible personal property held by it to or with the clerk of the superior court having jurisdiction of the probate proceedings relating to the decedent's estate, or if no proceedings have been commenced, to or with the clerk of the superior court having jurisdiction of probate proceedings relating to decedents' estates located in the county of the decedent's residence. The clerk shall hold the funds or item of property and, upon the clerk's determination under this Article, shall order disbursement in accordance with the determination. Payments, transfers, or deposits made to or with the clerk discharge the payor or other third party from all claims for the value of amounts paid to or items of property transferred to or deposited with the clerk.

(b) A person who purchases property for value and without notice, or who received a payment or other item of property in partial or full satisfaction of a legally enforceable obligation, is neither obligated under this Article to return the payment, item of property, or benefit, nor liable under this Article for the amount of the payment or the value of the item of property or benefit. But a person who, not for value, receives a payment, item of property, or any other benefit to which the person is not entitled under this Article is obligated to return the payment, item of property, or benefit, or is personally liable for the amount of the payment or the value of the item of property or benefit, to the person who is entitled to it under this Article. (2007-132, s. 1.)

Editor's Note. — Session Laws 2007-132, s. 5, made this section effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date.

ARTICLE 25.

Small Estates.

§ 28A-25-1. Collection of property by affidavit when decedent dies intestate.

(a) When a decedent dies intestate leaving personal property, less liens and encumbrances thereon, not exceeding ten thousand dollars ($10,000) in value, at any time after 30 days from the date of death, any person indebted to the decedent or having possession of tangible personal property or an instrument evidencing a debt, obligation, stock or chose in action belonging to the decedent shall make payment of the indebtedness or deliver the tangible personal property or an instrument evidencing a debt, obligation, stock or chose in action to a person claiming to be the public administrator appointed pursuant to G.S. 28A-12-1, or an heir or creditor of the decedent, not disqualified under G.S. 28A-4-2, upon being presented a certified copy of an affidavit filed in accordance with subsection (b) and made by or on behalf of the heir or creditor or the public administrator stating:

(1) The name and address of the affiant and the fact that he or she is the public administrator or an heir or creditor of the decedent;
(2) The name of the decedent and his residence at time of death;
(3) The date and place of death of the decedent;
(4) That 30 days have elapsed since the death of the decedent;
(5) That the value of all the personal property owned by the estate of the decedent, less liens and encumbrances thereon, does not exceed ten thousand dollars ($10,000);
(6) That no application or petition for appointment of a personal representative is pending or has been granted in any jurisdiction;
(7) The names and addresses of those persons who are entitled, under the provisions of the Intestate Succession Act, to the personal property of the decedent and their relationship, if any, to the decedent; and
(8) A description sufficient to identify each tract of real property owned by the decedent at the time of his death.

In those cases in which the affiant is the surviving spouse and sole heir of the decedent, not disqualified under G.S. 28A-4-2, the property described in this subsection that may be collected pursuant to this section may exceed ten thousand dollars ($10,000) in value but shall not exceed twenty thousand dollars ($20,000) in value. In such cases, the affidavit shall state: (i) the name and address of the affiant and the fact that he or she is the surviving spouse and is entitled, under the provisions of the Intestate Succession Act, to all of the property of the decedent; (ii) that the value of all of the personal property owned by the estate of the decedent, less liens and encumbrances thereon, does not exceed twenty thousand dollars ($20,000); and (iii) the information required under subdivisions (2), (3), (4), (6), and (8) of this subsection.

(b) Prior to the recovery of any assets of the decedent, a copy of the affidavit described in subsection (a) shall be filed in the office of the clerk of superior court of the county where the decedent had his domicile at the time of his death. The affidavit shall be filed by the clerk upon payment of the fee provided in G.S. 7A-307, shall be indexed in the index to estates, and a copy thereof shall be mailed by the clerk to the persons shown in the affidavit as entitled to the personal property.

(c) The presentation of an affidavit as provided in subsection (a) shall be sufficient to require the transfer to the affiant or his designee of the title and license to a motor vehicle registered in the name of the decedent owner; the ownership rights of a savings account or checking account in a bank in the name of the decedent owner; the ownership rights of a savings account or share certificate in a credit union, building and loan association, or savings and loan association in the name of the decedent owner; the ownership rights in any stock or security registered on the books of a corporation in the name of a decedent owner; or any other property or contract right owned by decedent at the time of his death. (1973, c. 1329, s. 3; 1975, c. 300, s. 9; 1983, c. 65, s. 1; c. 713, s. 21; 1985, c. 651, s. 1; 1989, c. 407, s. 1; 1995, c. 262, s. 1.)

CASE NOTES

Action Properly Dismissed Against Defendants Who Were Merely Collectors by Affidavit. — Where plaintiff was required by this statute to bring his action against the collector or personal representative, his action was properly dismissed when he filed his action against defendants who were merely collectors by affidavit under this section, since plaintiff failed to bring his action against the proper party or parties. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 323 N.C. 171, 373 S.E.2d 104 (1988).

Cited in Little v. Bennington, 109 N.C. App. 482, 427 S.E.2d 887 (1993).

§ 28A-25-1.1. Collection of property by affidavit when decedent dies testate.

(a) When a decedent dies testate leaving personal property, less liens and encumbrances thereon, not exceeding ten thousand dollars ($10,000) in value, at any time after 30 days from the date of death, any person indebted to the decedent or having possession of tangible personal property or an instrument evidencing a debt, obligation, stock or chose in action belonging to the decedent shall make payment of the indebtedness or deliver the tangible personal property or an instrument evidencing a debt, obligation, stock or chose in action to a person claiming to be the public administrator appointed pursuant to G.S. 28A-12-1, a person named or designated as executor in the will, devisee, heir or creditor, of the decedent, not disqualified under G.S. 28A-4-2, upon being presented a certified copy of an affidavit filed in accordance with subsection (b) and made by or on behalf of the heir, the person named or designated as executor in the will of the decedent, the creditor, the public administrator, or the devisee, stating:

(1) The name and address of the affiant and the fact that he is the public administrator, a person named or designated as executor in the will, devisee, heir or creditor, of the decedent;
(2) The name of the decedent and his residence at time of death;
(3) The date and place of death of the decedent;
(4) That 30 days have elapsed since the death of the decedent;
(5) That the decedent died testate leaving personal property, less liens and encumbrances thereon, not exceeding ten thousand dollars ($10,000) in value;
(6) That the decedent's will has been admitted to probate in the court of the proper county and a duly certified copy of the will has been recorded in each county in which is located any real property owned by the decedent at the time of his death;
(7) That a certified copy of the decedent's will is attached to the affidavit;

(8) That no application or petition for appointment of a personal representative is pending or has been granted in any jurisdiction;

(9) The names and addresses of those persons who are entitled, under the provisions of the will, or if applicable, of the Intestate Succession Act, to the property of the decedent; and their relationship, if any, to the decedent; and

(10) A description sufficient to identify each tract of real property owned by the decedent at the time of his death.

In those cases in which the affiant is the surviving spouse, is entitled to all of the property of the decedent, and is not disqualified under G.S. 28A-4-2, the property described in this subsection that may be collected pursuant to this section may exceed ten thousand dollars ($10,000) in value but shall not exceed twenty thousand dollars ($20,000) in value. In such cases, the affidavit shall state: (i) the name and address of the affiant and the fact that he or she is the surviving spouse and is entitled, under the provisions of the decedent's will, or if applicable, of the Intestate Succession Act, to all of the property of the decedent; (ii) that the decedent died testate leaving personal property, less liens and encumbrances thereon, not exceeding twenty thousand dollars ($20,000); and (iii) the information required under subdivisions (2), (3), (4), (6), (7), (8), and (10) of this subsection.

(b) Prior to the recovery of any assets of the decedent, a copy of the affidavit described in subsection (a) shall be filed in the office of the clerk of superior court of the county where the decedent had his domicile at the time of his death. The affidavit shall be filed by the clerk upon payment of the fee provided in G.S. 7A-307, shall be indexed in the index to estates, and a copy shall be mailed by the clerk to the persons shown in the affidavit as entitled to the property.

(c) The presentation of an affidavit as provided in subsection (a) shall be sufficient to require the transfer to the affiant or his designee of the title and license to a motor vehicle registered in the name of the decedent owner; the ownership rights of a savings account or checking account in a bank in the name of the decedent owner; the ownership rights of a savings account or share certificate in a credit union, building and loan association, or savings and loan association in the name of the decedent owner; the ownership rights in any stock or security registered on the books of a corporation in the name of a decedent owner; or any other property or contract right owned by decedent at the time of his death. (1985, c. 651, s. 2; 1987, c. 670, s. 1; 1989, c. 407, s. 2; 1995, c. 262, s. 2.)

§ 28A-25-2. Effect of affidavit.

The person paying, delivering, transferring or issuing personal property or the evidence thereof pursuant to an affidavit meeting the requirements of G.S. 28A-25-1(a) or G.S. 28A-25-1.1(a) is discharged and released to the same extent as if he dealt with a duly qualified personal representative of the decedent. He is not required to see to the application of the personal property or evidence thereof or to inquire into the truth of any statement in the affidavit. If any person to whom an affidavit is delivered refuses to pay, deliver, transfer, or issue any personal property or evidence thereof, it may be recovered or its payment, delivery, transfer, or issuance compelled upon proof of their right in an action brought for that purpose by or on behalf of the persons entitled thereto. The court costs and attorney's fee incident to the action shall be taxed against the person whose refusal to comply with the provisions of G.S. 28A-25-1(a) or G.S. 28A-25-1.1(a) made the action necessary. The heir or creditor to whom payment, delivery, transfer or issuance is made is answerable and accountable therefore to any duly qualified personal representative or collector of the decedent's estate or to any other person having an interest in the estate. (1973, c. 1329, s. 3; 1985, c. 651, s. 3; 1987, c. 670, s. 2.)

§ 28A-25-3. Disbursement and distribution of property collected by affidavit.

(a) If there has been no personal representative or collector appointed by the clerk of superior court, the affiant who has collected personal property of the decedent by affidavit pursuant to G.S. 28A-25-1 or G.S. 28A-25-1.1 shall:

(1) Disburse and distribute the same in the following order:

a. To the payment of the surviving spouse's year's allowance and the children's year's allowance assigned in accordance with G.S. 30-15 through G.S. 30-33;

b. To the payment of the debts and claims against the estate of the decedent in the order of priority set forth in G.S. 28A-19-6, or to the reimbursement of any person who has already made payment thereof;

c. To the distribution of the remainder of the personal property to the persons entitled thereto under the provisions of the will or of the Intestate Succession Act; and

(2) File an affidavit with the clerk of superior court that he has collected the personal property of the decedent and the manner in which he has disbursed and distributed the same. This final affidavit shall be filed within 90 days of the date of filing of the qualifying affidavit provided for in G.S. 28A-25-1 or G.S. 28A-25-1.1. If the affiant cannot file the final affidavit within 90 days, he shall file a report with the clerk within that time period stating his reasons. Upon determining that the affiant has good reason not to file the final affidavit within 90 days, the clerk may extend the time for filing up to one year from the date of filing the qualifying affidavit.

(b) Nothing in this section shall be construed as changing the rule of G.S. 28A-15-1 and G.S. 28A-15-5 rendering both real and personal property, without preference or priority, available for the discharge of debts and other claims against the estate of the decedent. If it appears that it may be in the best interest of the estate to sell, lease, or mortgage any real property to obtain money for the payment of debts or other claims against the decedent's estate, the affiant shall petition the clerk of superior court for the appointment of a personal representative to conclude the administration of the decedent's estate pursuant to G.S. 28A-25-5. (1973, c. 1329, s. 3; 1983, c. 711, s. 1; 1985, c. 651, s. 4; 1987, c. 670, s. 3; 1989, c. 407, s. 3.)

CASE NOTES

Action Properly Dismissed Against Defendants Who Were Merely Collectors by Affidavit. — Where plaintiff was required by this statute to bring his action against the collector or personal representative, his action was properly dismissed when he filed his action against defendants who were merely collectors by affidavit under G.S. 28A-25-1, since plaintiff failed to bring his action against the proper party or parties. Brace v. Strother, 90 N.C. App. 357, 368 S.E.2d 447, cert. denied, 323 N.C. 171, 373 S.E.2d 104 (1988).

Cited in Ragan v. Hill, 337 N.C. 667, 447 S.E.2d 371 (1994).

§ 28A-25-4. Clerk may compel compliance.

If any affiant who has collected personal property of the decedent by affidavit pursuant to G.S. 28A-25-1 or G.S. 28A-25-1.1 shall fail to make distribution or file affidavit as required by G.S. 28A-25-3, the clerk of superior court may, upon his own motion or at the request of any interested person, issue an attachment against him for a contempt and commit him until he makes proper distribution and files the affidavit. In addition to or in lieu of filing this attachment, the clerk may require the affiant to post a bond conditioned as provided in G.S. 28A-8-2. (1973, c. 1329, s. 3; 1983, c. 711, s. 2; 1985, c. 651, s. 5; 1987, c. 670, s. 4; 1989, c. 407, s. 4.)

CASE NOTES

Challenging Order Under This Section. — Order of contempt and commitment entered against plaintiff-executor for failure to file account on estate and to appear and show cause was a valid court order pursuant to this section. In contesting this court order, plaintiff's proper course of action would have been to appeal the order itself. Instead, plaintiff attacked the order by seeking declaratory relief and the expunction of his records in a wholly separate action. The trial court had no authority to grant plaintiff the relief sought in that it had no power collaterally to vacate the order of contempt and commitment. Therefore, the trial court's dismissal of plaintiff's claim under Rules 12(b)(1) and (6) was proper. Little v. Bennington, 109 N.C. App. 482, 427 S.E.2d 887 (1993), pet. disc. review denied, 334 N.C. 164, 432 S.E.2d 362 (1993).

§ 28A-25-5. Subsequently appointed personal representative or collector.

Nothing in this Article shall preclude any interested person, including the affiant, from petitioning the clerk of superior court for the appointment of a personal representative or collector to conclude the administration of the decedent's estate. If such is done, the affiant who has been collecting personal property by affidavit shall cease to do so, shall deliver all assets in his possession to the personal representative, and shall render a proper accounting to the personal representative or collector. A copy of the accounting shall also be filed with the clerk having jurisdiction over the personal representative or collector. (1973, c. 1329, s. 3; 1975, c. 300, s. 10; 1985, c. 651, s. 6; 1987, c. 670, s. 5.)

§ 28A-25-6. Payment to clerk of money owed decedent.

(a) As an alternative to the small estate settlement procedures of this Article, any person indebted to a decedent may satisfy such indebtedness by paying the amount of the debt to the clerk of the superior court of the county of the domicile of the decedent:

(1) If no administrator has been appointed, and
(2) If the amount owed by such person does not exceed five thousand dollars ($5,000), and
(3) If the sum tendered to the clerk would not make the aggregate sum which has come into the clerk's hands belonging to the decedent exceed five thousand dollars ($5,000).

(b) Such payments may not be made to the clerk if the total amount paid or tendered with respect to any one decedent would exceed five thousand dollars ($5,000), even though disbursements have been made so that the aggregate amount in the clerk's hands at any one time would not exceed five thousand dollars ($5,000).

(c) If the sum tendered pursuant to this section would make the aggregate sum coming into the clerk's hands with respect to any one decedent exceed five thousand dollars ($5,000) the clerk shall appoint an administrator, or the sum may be administered under the preceding sections of this Article.

(d) If it appears to the clerk after making a preliminary survey that disbursements pursuant to this section would not exhaust funds received pursuant to this section, he may, in his discretion, appoint an administrator, or the funds may be administered under the preceding sections of this Article.

(e) The receipt from the clerk of the superior court of a payment purporting to be made pursuant to this section is a full release to the debtor for the payment so made.

(f) If no administrator has been appointed, the clerk of superior court shall disburse the money received under this section for the following purposes and in the following order:

(1) To pay the surviving spouse's year's allowance and children's year's allowance assigned in accordance with law;

(2), (3) Repealed by Session Laws 1981, c. 383, s. 3.

(4) All other claims shall be disbursed according to the order set out in G.S. 28A-19-6.

Notwithstanding the foregoing provisions of this subsection, the clerk shall pay, out of funds provided the deceased pursuant to G.S. 111-18 and Part 3 of Article 2 of Chapter 108A of the General Statutes of North Carolina, any lawful claims for care provided by an adult care home to the deceased, incurred not more than 90 days prior to his death. After the death of a spouse who died intestate and after the disbursements have been made in accordance with this subsection, the balance in the clerk's hands belonging to the estate of the decedent shall be paid to the surviving spouse, and if there is no surviving spouse, the clerk shall pay it to the heirs in proportion to their respective interests.

(g) The clerk shall not be required to publish notice to creditors.

(h) Whenever an administrator is appointed after a clerk of superior court has received any money pursuant to this section, the clerk shall pay to the administrator all funds which have not been disbursed. The clerk shall receive no commissions for payments made to the administrator, and the administrator shall receive no commissions for receiving such payments. (1921, c. 93; Ex. Sess. 1921, c. 65; C.S., s. 65(a); Ex. Sess. 1924, cc. 15, 58; 1927, c. 7; 1929, cc. 63, 71, 121; 1931, c. 21; 1933, cc. 16, 94; 1935, cc. 69, 96, 367; 1937, cc. 13, 31, 55, 121, 336, 377; 1939, cc. 383, 384; 1941, c. 176; 1943, cc. 24, 114, 138, 560; 1945, cc. 152, 178, 555; 1947, cc. 203, 237; 1949, cc. 17, 81, 691, 762; 1951, c. 380, s. 1; 1955, c. 1246, s. 103; 1957, c. 491; 1959, c. 795, ss. 1-4; 1965, c. 576, s. 1; 1973, c. 23; c. 1329, s. 1; 1975, c. 344; 1979, c. 163; c. 762, s. 1; 1981, c. 383, s. 3; 1983, c. 65, s. 2; 1987, c. 282, s. 6; 1989 (Reg. Sess., 1990), c. 1015, s. 1; 1995, c. 535, s. 2.)

Cross References. — As to order of payment of debts, see G.S. 28A-19-6. As to intestate succession generally, see G.S. 29-1 et seq.

Editor's Note. — This section combines former G.S. 28-68, 28-68.1, 28-68.2 and 28-68.3. The provisions of the former sections were rewritten, combined and transferred to their present position by Session Laws 1975, c. 344.

Session Laws 1995, c. 535, which amended this section, in s. 37 provides: "Rules adopted by the Department of Human Resources, the Medical Care Commission, and the Social Services Commission regulating domiciliary care homes prior to the effective date of this act remain in effect for adult care homes until amended or repealed."

CASE NOTES

This section provides the debtor a permissive right, and is in no wise mandatory upon him; such right as is given is alternative and not exclusive. In re Franks, 220 N.C. 176, 16 S.E.2d 831 (1941), decided under prior law.

Effect on Jurisdiction to Appoint Administrator. — This section does not have the effect of fixing the sum of $300 (now $5,000) as bona notabilia in determining jurisdiction of the clerk of the superior court to appoint an administrator for a person not domiciled in this State who dies leaving assets herein. In re Franks, 220 N.C. 176, 16 S.E.2d 831 (1941), decided under prior law.

Section Not Applicable to Surplus Realized on Foreclosure Sale. — The limitation of the amount payable to the clerk under this section is not applicable to the surplus realized upon the foreclosure of a mortgage or deed of trust. Lenoir County v. Outlaw, 241 N.C. 97, 84 S.E.2d 330 (1954), rehearing denied, 241 N.C. 97, 85 S.E.2d 608 (1955), decided under prior law.

ARTICLE 26.

Foreign Personal Representatives and Ancillary Administration.

§ 28A-26-1. Domiciliary and ancillary probate and administration.

The domiciliary, or original, administration of the estates of all decedents domiciled in North Carolina at the time of death shall be under the jurisdiction of this State and of a proper clerk of superior court in this State, and the original probate of all wills of such persons shall be in this State. Any administration of the estate and any probate of a will of such decedents outside North Carolina shall be ancillary only. All assets, except real estate (but including proceeds from the sale of real estate), subject to ancillary administration in a jurisdiction outside North Carolina shall, to the extent such assets are not necessary for the requirements of such ancillary administration, be transferred and delivered by the ancillary personal representative to the duly qualified personal representative in this State for administration and distribution by the domiciliary personal representative, and the domiciliary personal representative in this State shall have the duty of collecting all such assets from the ancillary personal representative. The receipt of the domiciliary personal representative shall fully acquit the ancillary personal representative with respect to the assets covered thereby. The domiciliary personal representative in North Carolina shall have the exclusive right and duty to pay all federal and North Carolina taxes owed by the estate of such decedent and to make proper distribution of all assets including those collected from the ancillary personal representative. (1963, c. 634; 1973, c. 1329, s. 3.)

§ 28A-26-2. Payment of debt and delivery of property to domiciliary personal representative of a nonresident decedent without ancillary administration in this State.

(a) At any time after the expiration of 60 days from the death of a nonresident decedent, any resident of this State indebted to the estate of the nonresident decedent or having possession or control of personal property, or of an instrument evidencing a debt, obligation, stock or chose in action belonging to the estate of the nonresident decedent may pay the debt or deliver the personal property, or the instrument evidencing the debt, obligation, stock or chose in action, to the domiciliary personal representative of the nonresident decedent upon being presented with a certified or exemplified copy of his letters of appointment and an affidavit made by or on behalf of the domiciliary personal representative stating:

(1) The date of the death of the nonresident decedent;
(2) That to the best of his knowledge no administration, or application or petition therefor, is pending in this State;
(3) That the domiciliary personal representative is entitled to payment or delivery.

(b) Payment or delivery made in good faith on the basis of the proof of appointment as domiciliary personal representative of a nonresident decedent and an affidavit meeting the requirements of subsection (a) constitutes a release to the same extent as if payment or delivery had been made to an ancillary personal representative.

(c) Payment or delivery under this section shall not be made if a resident creditor of the nonresident decedent has, by registered or certified mail, notified the resident debtor of the nonresident decedent or the resident having possession of the personal property belonging to the nonresident decedent that the debt should not be paid nor the property delivered to the domiciliary personal representative of the nonresident decedent. If no ancillary administrator qualifies within 90 days from the date of the notice, however, the resident debtor may pay the debt or deliver the property directly to the nonresident domiciliary personal representative as set forth in subsection (a) of this section. (1973, c. 1329, s. 3; 1975, c. 300, s. 11.)

§ 28A-26-3. Ancillary administration.

(a) Any domiciliary personal representative of a nonresident decedent upon the filing of a certified or exemplified copy of letters of appointment with the clerk of superior court who has venue under G.S. 28A-3-1 may be granted ancillary letters in this State notwithstanding that the domiciliary personal representative is a nonresident of this State or is a foreign corporation. If the domiciliary personal representative is a foreign corporation, it need not qualify under any other law of this State to authorize it to act as ancillary personal representative in the particular estate. If application is made for the issuance of ancillary letters to the domiciliary personal representative, the clerk of superior court shall give preference in appointment to the domiciliary personal representative unless the decedent shall have otherwise directed in a will.

(b) If, within 90 days after the death of the nonresident, or within 60 days after issue of domiciliary letters, should that be a shorter period, no application for ancillary letters has been made by a domiciliary personal representative, any person who could apply for issue of letters had the decedent been a resident may apply for issue of ancillary letters.

If it is known that there is a duly qualified domiciliary personal representative, the clerk of superior court shall send notice of such application, by registered mail, to that personal representative and to the appointing court. Such notice shall include a statement that, within 14 days after its mailing, the domiciliary personal representative may apply for the issue of ancillary letters with the preference specified in subsection (a) of this section; and that his failure to do so will be deemed a waiver, with the result that letters will be issued to another. Upon such failure, the clerk of superior court may issue ancillary letters in accordance with the provisions of Article 4 of this Chapter.

If the applicant and the clerk of superior court have no knowledge of the existence of a domiciliary personal representative, the clerk of superior court may proceed to issue ancillary letters. Subsequently, upon it becoming known that a domiciliary personal representative has been appointed, whether such appointment occurred before or after the issue of ancillary letters, the clerk of superior court shall notify the domiciliary personal representative, by registered mail, of the action taken by the clerk of superior court and the state of the ancillary administration. Such notice shall include a statement that at any time prior to approval of the ancillary personal representative's final account the domiciliary personal representative may appear in the proceedings for any purpose he may deem advisable; and that he may apply to be substituted as ancillary personal representative, but that such request will not be granted unless the clerk of superior court finds that such action will be for the best interests of North Carolina administration of the estate. (1973, c. 1329, s. 3.)

Legal Periodicals. — For note on the Erie Doctrine and Rule 15(c), see 16 Wake Forest L. Rev. 621 (1980).

CASE NOTES

Applied in Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Cited in Messer v. American Gems, Inc., 612 F.2d 1367 (4th Cir. 1980); In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980).

§ 28A-26-4. Bonds.

(a) Subject to the exception in subsection (b), any personal representative, including a domiciliary personal representative, who is granted ancillary letters of administration in this State must satisfy the bond requirements prescribed in Article 8 of this Chapter.

(b) Where a citizen or subject of a foreign country, or of any other state or territory of the United States, by will sufficient according to the laws of this State, and duly probated and recorded in the proper county, devises to his executor, with power to sell and convey, real property situated in this State in trust for a person named in the will, the power being vested in the executor as such trustee, the executor may execute the power without giving bond in this State. (1911, c. 176; C.S., s. 37; Ex. Sess. 1920, c. 86; 1945, c. 652; 1957, c. 320; 1969, c. 1067, ss. 1, 2; 1973, c. 1329, s. 3.)

§ 28A-26-5. Authority of domiciliary personal representative of a nonresident decedent.

The domiciliary personal representative of the nonresident decedent after qualifying as ancillary personal representative in this State is authorized to administer the North Carolina estate of the nonresident decedent in accordance with the provisions of this Chapter. (1973, c. 1329, s. 3.)

CASE NOTES

Cited in In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980).

§ 28A-26-6. Jurisdiction.

(a) A domiciliary personal representative of a nonresident decedent may invoke the jurisdiction of the courts of this State after qualifying as ancillary personal representative in this State except that he may invoke such jurisdiction prior to qualification for the purpose of appealing from a decision of the clerk of superior court regarding a question of qualification.

(b) A domiciliary personal representative of a nonresident decedent submits to the jurisdiction of the courts of this State:

(1) As provided in G.S. 1-75.4, or
(2) By receiving payment of money or taking delivery of personal property under G.S. 28A-26-2; or
(3) By acceptance of ancillary letters of administration in this State under G.S. 28A-26-3; or
(4) By doing any act as personal representative in this State which if done as an individual would have given the State jurisdiction over him as an individual. (1973, c. 1329, s. 3.)

CASE NOTES

Claims Brought by Foreign Personal Representative Before Qualifying Locally. — This section neither addresses nor answers the question of what must happen procedurally to a claim brought by a foreign personal representative who locally qualifies after the claim is filed. Indeed, G.S. 28A-13-1 speaks more to this question. Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

This section does not mean that a claim filed by a foreign personal representative who has not yet locally qualified is a nullity ab initio requiring the institution of a new claim after qualification. At most, it is simply another way of saying that the foreign administrator must qualify locally before he has capacity to sue in North Carolina. Burcl v. North Carolina Baptist Hosp., 306 N.C. 214, 293 S.E.2d 85 (1982).

Applied in Powles v. Kandrasiewicz, 886 F. Supp. 1261 (W.D.N.C. 1995).

§ 28A-26-7. Service on personal representative of a nonresident decedent.

A court of this State having jurisdiction of the subject matter and grounds for personal jurisdiction as provided in G.S. 28A-26-6 may exercise personal jurisdiction over a defendant by service of process in accordance with the provisions of G.S. 1A-1, Rule 4(j). (1973, c. 1329, s. 3.)

§ 28A-26-8. Duties of personal representative in an ancillary administration.

(a) All assets of estates of nonresident decedents being administered in this State are subject to all claims, allowances and charges existing or established against the estate of the decedent wherever existing or established.

(b) An adjudication of a claim rendered in any jurisdiction in favor of or against any personal representative of the estate of a nonresident decedent is binding on the ancillary personal representative in this State and on all parties to the litigation.

(c) Limitations on presentation of claims shall be governed by the provisions of this Chapter except that creditors residing in the domiciliary state barred by the statutes of that state may not file claims in an ancillary administration in this State.

(d) In the payment of claims by the ancillary administrator, the following rules shall apply:

(1) If the value of the entire estate, wherever administered, equals or exceeds family exemptions and allowances, prior charges and claims against the entire estate, the claims allowed in this State shall be paid in full from assets in this State, if such assets are sufficient for the purpose.

(2) If such total exemptions, allowances, charges and claims exceed the value of the entire estate, the claims allowed in this State shall be paid their proper percentage pro rata by class, if assets in this State are sufficient for the purpose.

(3) If assets in this State are inadequate for either of the purposes stated in subdivisions (1) or (2) above, the claims allowed in this State shall be paid, pro rata by class, to the extent the local assets will permit.

(4) If the value of the entire estate, wherever administered, is insufficient to pay all exemptions and allowances, prior charges and claims against the entire estate, the priority for order of payment established by the law of the domicile will prevail. (1973, c. 1329, s. 3; 1975, c. 19, ss. 10, 11.)

CASE NOTES

Applied in In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980).

§ 28A-26-9. Remission of surplus assets by ancillary personal representative to domiciliary personal representative.

Unless a testator in a will otherwise directs, any assets (including proceeds from the sale of real estate) remaining after payment of claims against the estate of a nonresident decedent being administered by an ancillary personal representative other than the domiciliary personal representative shall be transferred and delivered to the domiciliary personal representative or, if none, to the court in the domicile of the decedent which has jurisdiction to administer the estate. (1973, c. 1329, s. 3.)

ARTICLE 27.

Apportionment of Federal Estate Tax.

§ 28A-27-1. Definitions.

For the purposes of this Article:

(1) "Estate" means the gross estate of a decedent as determined for the purpose of the federal estate tax.
(2) "Fiduciary" includes a personal representative and a trustee.
(3) "Person" means any individual, partnership, association, joint stock company, corporation, governmental agency, including any multiples or combinations of the foregoing as, for example, individuals as joint tenants.
(4) "Person interested in the estate" means any person, including a personal representative, guardian, or trustee, entitled to receive, or who has received, from a decedent while alive or by reason of the death of a decedent any property or interest therein included in the decedent's taxable estate.
(5) "State" means any state, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico.
(6) "Tax" means the net Federal Estate Tax due, after application of any available unified transfer tax credit, and interest and penalties imposed in addition to the tax. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

Cross References. — As to the applicability of the provisions of this Article, see G.S. 28A-27-9.

§ 28A-27-2. Apportionment.

(a) Except as otherwise provided in subsection (b) of this section, or in G.S. 28A-27-5, G.S. 28A-27-6, or G.S. 28A-27-8, the tax shall be apportioned among all persons interested in the estate in the proportion that the value of the interest of each person interested in the estate bears to the total value of the interests of all persons interested in the estate. The values as finally determined for federal estate tax purposes shall be used for the purposes of this computation.

(b) In the event the decedent's will provides a method of apportionment of the tax different from the method provided in subsection (a) above, the method described in the will shall control. However, in the case of any will executed on or after October 1, 1986, a general direction in the will that taxes shall not be apportioned, whether or not referring to this Article, but shall be paid from the residuary portion of the estate shall not, unless specifically stated otherwise, apply to taxes imposed on assets which are includible in the valuation of the decedent's gross estate for federal estate tax purposes only by reason of Sections 2041, 2042 or 2044 of the Internal Revenue Code of 1954 or corresponding provisions of any subsequent tax law. In the case of an estate administered under any will executed on or after October 1, 1986, in the event that the estate tax computation involves assets described in the preceding sentence, unless specifically stated otherwise, apportionment shall be made against such assets and the tax so apportioned shall be recovered from the persons receiving such assets as provided in Sections 2206, 2207 or 2207A of the Internal Revenue Code of 1954 or corresponding provisions of any subsequent tax law. (1985 (Reg. Sess., 1986), c. 878, s. 1; 1987, c. 694, s. 1.)

CASE NOTES

Applied in Estate of Bradford v. Comm'r, T.C. Memo 2002-238, 2002 Tax Ct. Memo LEXIS 245 (Sept. 23, 2002).

Cited in Branch Banking & Trust Co. v. Staples, 120 N.C. App. 227, 461 S.E.2d 921 (1995).

§ 28A-27-3. Procedure for determining apportionment.

(a) The personal representative of a decedent shall determine the apportionment of the tax.

(b) If the personal representative finds that it is inequitable to apportion interest and penalties in the manner provided in this Article because such interest or penalties were imposed due to the fault of one or more persons interested in the estate he may direct apportionment thereon in the manner he finds equitable.

(c) The expenses reasonably incurred by the personal representative in connection with the apportionment of the tax shall be apportioned as provided for taxes under this Article. If the personal representative finds that it is inequitable to apportion the expenses because such expenses were incurred because of the fault of one or more persons interested in the estate he may direct other more equitable apportionment. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

§ 28A-27-4. Uncollected tax.

The personal representative shall not be under any duty to institute any suit or proceeding to recover from any person interested in the estate the amount of the tax apportioned to the person until the expiration of the six months next following final determination of the tax. A personal representative who institutes the suit or proceeding within a reasonable time after the six months' period shall not be subject to any liability or surcharge because any portion of the tax apportioned to any person interested in the estate was collectable at a time following the death of the decedent but thereafter became uncollectable. If the personal representative cannot collect from any person interested in the estate the amount of the tax apportioned to the person, the amount not recoverable shall be apportioned among the other persons interested in the estate who are subject to apportionment. The apportionment shall be made in the proportion that the value of the interest of each remaining person interested in the estate bears to the total value of the interests of all remaining persons interested in the estate. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

§ 28A-27-5. Exemptions, deductions, and credits.

(a) Any interest for which a deduction or exemption is allowed under the federal revenue laws in determining the value of the decedent's net taxable estate, such as property passing to or in trust for a surviving spouse and gifts or bequests for charitable, public, or similar purposes, shall not be included in the computation provided for in G.S. 28A-27-2 to the extent of the allowable deduction or exemption. When such an interest is subject to a prior present interest which is not allowable as a deduction or exemption, such present interest shall not be included in the computation provided for in this Article and no tax shall be apportioned to or paid from principal.

(b) Any credit for property previously taxed and any credit for gift taxes or death taxes of a foreign country paid by the decedent or his estate shall inure to the proportionate benefit of all persons liable to apportionment; provided, however, that if the tax which gives rise to such a credit has in fact been paid by a person interested in the estate, the benefit of such credit shall inure to that person paying the tax.

(c) Any credit for inheritance, succession, or estate taxes or taxes in the nature thereof in respect to property or interests includible in the estate shall inure to the benefit of the persons or interests chargeable with the payment thereof to the extent that, or in the proportion that, the credit reduces the tax.

(d) To the extent that property passing to or in trust for a surviving spouse or any charitable, public, or similar gift or bequest does not constitute an allowed deduction for purposes of the tax solely by reason of an inheritance tax or other death tax imposed upon and deductible from the property, the property shall not be included in the computation provided for in this Article, and to that extent no apportionment shall be made against the property. This section does not apply in any instance where the result will be to deprive the estate of a deduction otherwise allowable under Section 2053(d) of the Internal Revenue Code of 1954 of the United States or corresponding provisions of any subsequent tax law, relating to deduction for State death taxes on transfers for public charitable or religious uses. (1985 (Reg. Sess., 1986), c. 878, s. 1; 1987, c. 694, ss. 2, 3.)

CASE NOTES

Applied in Estate of Bradford v. Comm'r, T.C. Memo 2002-238, 2002 Tax Ct. Memo LEXIS 245 (Sept. 23, 2002).

§ 28A-27-6. No apportionment between temporary and remainder interests.

No interest in income and no estate for years or for life or other temporary interest in any property or fund is subject to apportionment as between the temporary interest and the remainder. The tax on the temporary interest and the tax, if any, on the remainder is chargeable against the corpus of the property or funds subject to the temporary interest and remainder. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

§ 28A-27-7. Fiduciary's rights and duties.

(a) The personal representative may withhold from any property of the decedent in his possession, distributable to any person interested in the estate, the amount of the tax apportioned to his interest. If the property in possession of the personal representative and distributable to any person interested in the estate tax is insufficient to satisfy the proportionate amount of the tax determined to be due from the person, the personal representative may recover the deficiency from the person interested in the estate. If the property is not in the possession of the personal representative he may recover from any person interested in the estate the amount of the tax apportioned to the person in accordance with this Article.

(b) If property held by the fiduciary or other person is distributed prior to final apportionment of the tax, the personal representative may require the distributee to provide a bond or other security for the apportionment liability in the form and amount prescribed by the fiduciary, with the approval of the clerk of superior court having jurisdiction of the administration of the estate. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

§ 28A-27-8. Difference with Federal Estate Tax Law.

If the liabilities of persons interested in the estate as prescribed by this Article differ from those which result under the Federal Estate Tax Law, the liabilities imposed by the federal law will control and the balance of this Article shall apply as if the resulting liabilities had been prescribed herein. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

§ 28A-27-9. Effective date.

The provisions of this Article shall not apply to taxes due on account of the death of decedents dying prior to October 1, 1986. (1985 (Reg. Sess., 1986), c. 878, s. 1.)

Article 28.

Summary Administration.

§ 28A-28-1. Summary administration where spouse is sole beneficiary.

When a decedent dies testate or intestate leaving a surviving spouse as the sole devisee or heir, the surviving spouse may file a petition for summary administration with the clerk of superior court of the county where the decedent was domiciled at the time of death. This procedure is available if the decedent died partially testate, provided that the surviving spouse is the sole devisee under the will and the sole heir of the decedent's intestate property. This procedure is not available if the decedent's will provides that it is not available or if the devise to the surviving spouse is in trust rather than outright. (1995, c. 294, s. 1.)

Legal Periodicals. — For article, "Perpetuities Reform in North Carolina: The Uniform Statutory Rule Against Perpetuities, Nondonative Transfers, and Honorary Trusts," see 74 N.C.L. Rev. 1783 (1996).

§ 28A-28-2. Petition.

(a) The petition shall be signed by the surviving spouse and verified to be accurate and complete to the best of the spouse's knowledge and belief and shall state as follows:

(1) The name and address of the spouse and the fact that he or she is the surviving spouse of the decedent;
(2) The name and domicile of the decedent at the time of death;
(3) The date and place of death of the decedent;
(4) The date and place of marriage of the spouse and the decedent;
(5) A description sufficient to identify each tract of real property owned in whole or in part by the decedent at the time of death;
(6) A description of the nature of the decedent's personal property and the location of such property, as far as these facts are known or can with reasonable diligence be ascertained;
(7) The probable value of the decedent's personal property, so far as the value is known or can with reasonable diligence be ascertained;
(8) That no application or petition for appointment of a personal representative is pending or has been granted in this State;
(9) That the spouse is the sole devisee or sole heir, or both, of the decedent, and that there is no other devisee or heir; that the decedent's will, if any, does not prohibit summary administration; and that any property passing to the spouse under the will is not in trust;
(10) The name and address of any executor or coexecutor named by the will and that, if the decedent died testate, a copy of the petition has been personally delivered or sent by first-class mail by the spouse to the last-known address of any executor or coexecutor named by the will, if different from the spouse;
(11) That, to the extent of the value of the property received by the spouse under the will of the decedent or by intestate succession, the spouse assumes all liabilities of the decedent that were not discharged by reason of death and assumes liability for all taxes and valid claims against the decedent or the estate, as provided in G.S. 28A-28-6; and
(12) If the decedent died testate, that the decedent's will has been admitted to probate in the court of the proper county; that a duly certified copy of the will has been recorded in each county in which is located any real property owned by the decedent at the time of death; and that a certified copy of the decedent's will is attached to the petition.

(b) The petition shall be filed by the clerk upon payment of the fee provided in G.S. 7A-307 and shall be indexed in the index to estates. (1995, c. 294, s. 1; c. 509, s. 135.2(a).)

§ 28A-28-3. Clerk's order.

If it appears to the clerk that the petition and supporting evidence, if any, comply with the requirements of G.S. 28A-28-2 and on the basis thereof the spouse is entitled to summary administration, the clerk shall enter an order to that effect and no further administration of the estate is necessary. Nothing in this section shall preclude a petition under the provisions of G.S. 28A-28-7(a) or the appointment of a personal representative or a collector under the provisions of Article 6 or Article 11 of this Chapter. (1995, c. 294, s. 1.)

§ 28A-28-4. Effect of order.

(a) The presentation of a certified copy of the order described in G.S. 28A-28-3 shall be sufficient to require the transfer to the spouse of any property or contract right owned by the decedent at the time of death, including but not limited to: (i) wages and salary; (ii) the title and license to a motor vehicle registered in the name of the decedent owner; (iii) the ownership rights of a savings account, checking account, or certificate of deposit in a bank in the name of the decedent owner; (iv) the ownership rights of a savings account, share certificate, or certificate of deposit in a credit union, building and loan association, or savings and loan association in the name of the decedent owner; and (v) the ownership rights in any stock or security registered on the books of a corporation in the name of the decedent owner.

(b) After the entry of the order described in G.S. 28A-28-3, the spouse may convey, lease, sell, or mortgage any real property devised to or inherited by the spouse from the decedent, at public or private sale, upon such terms as the spouse may determine. This section shall not limit any other powers the spouse may have over property devised to or inherited by the spouse from the decedent. The provisions of G.S. 28A-17-12 are not applicable to a conveyance, sale, lease, or mortgage under this subsection. (1995, c. 294, s. 1.)

§ 28A-28-5. Effect of payment.

The person paying, delivering, transferring, or issuing property or the evidence thereof pursuant to the order described in G.S. 28A-28-3 is discharged and released to the same extent as if the person dealt with a duly qualified personal representative of the decedent. The person is not required to see to the application of the property or evidence thereof or to inquire into the truth of any statement in the petition or order.

If any person to whom the order is presented refuses to pay, deliver, transfer, or issue any property or evidence thereof, the property may be recovered or its payment, delivery, transfer, or issuance may be compelled in an action brought for that purpose by the surviving spouse. The court costs and attorney's fee incident to the action shall be taxed against the person whose refusal to comply with the provisions of G.S. 28A-28-4 made the action necessary. (1995, c. 294, s. 1.)

§ 28A-28-6. Spouse's assumption of liabilities.

If the clerk grants the order for summary administration, the spouse shall be deemed to have assumed, to the extent of the value of the property received by the spouse under the will of the decedent or by intestate succession, all liabilities of the decedent that were not discharged by reason of death and liability for all taxes and valid claims against the decedent or the estate. The value of the property is the fair market value of the property on the date of death of the decedent less any liens or encumbrances on the property so received. The spouse may assert any defense, counterclaim, cross-claim, or setoff which would have been available to the decedent if the decedent had not died except for actions listed in G.S. 28A-18-1(b). A spouse shall not be deemed to have assumed any liabilities of the decedent that were discharged by reason of death. (1995, c. 294, s. 1.)

§ 28A-28-7. Right to petition for appointment of personal representative; discharge of spouse's liability.

(a) Nothing in this Article shall preclude any person qualified to serve as personal representative pursuant to G.S. 28A-4-1, including the surviving spouse, from petitioning the clerk of superior court for the appointment of a personal representative or collector to administer the decedent's estate. If a personal representative or collector is appointed, the spouse shall render a proper accounting to the personal representative or collector and file a copy of the accounting with the clerk. The spouse shall deliver assets of the decedent's estate, cash, or other property and shall be discharged of liability in accordance with the provisions of subsection (b) of this section.

(b) In the event that a personal representative or collector is appointed, the spouse shall be discharged of liability for the debts of the decedent as follows:

(1) If the spouse delivers to the personal representative or collector all of the property received by the spouse in the identical form that it was received by the spouse, then the spouse will be discharged of all liability.

(2) If the spouse does not deliver to the personal representative or collector all of the property in the identical form that it was received by the spouse, then the spouse shall be discharged of liability as follows:

a. For property delivered to the personal representative or collector that is in the identical form that it was received by the spouse, the spouse is discharged to the extent of the fair market value of the property at the time of the decedent's death or the fair market value at the time the property was received by the personal representative or collector, whichever is greater.

b. For property delivered to the personal representative or collector that is not in the identical form that it was received by the spouse, the spouse is discharged to the extent of the fair market value of such property at the time it was delivered to the personal representative or collector. (1995, c. 294, s. 1.)

Legal Periodicals. — For article, "Perpetuities Reform in North Carolina: The Uniform Statutory Rule Against Perpetuities, Nondonative Transfers, and Honorary Trusts," see 74 N.C.L. Rev. 1783 (1996).

Chapter 28B.

Estates of Absentees in Military Service.

Sec.
28B-1. Absentee in military service; definition.
28B-2. Action for receiver; jurisdiction; contents of complaint.
28B-3. Notice; hearing; guardian ad litem.
28B-4. Order of appointment.
28B-5. Bond; inventory; accounting.
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Sec.
28B-7. Resignation and removal.
28B-8. Termination of receivership.
28B-9. Specific property valued at less than $5,000; summary procedure.
28B-10. Specific property valued at more than $5,000; summary procedure.

§ 28B-1. Absentee in military service; definition.

Any person serving in or with the armed forces of the United States, in or with the Red Cross, in or with the merchant marines, during any time when a state of hostilities exists between the United States and any other power, who has been reported or listed by the appropriate federal agency as missing in action or as a prisoner of war for a period of one year, shall be an "absentee in military service" within the meaning of this Chapter. (1973, c. 522, s. 1.)

§ 28B-2. Action for receiver; jurisdiction; contents of complaint.

(a) Whenever any absentee in military action as defined in this Chapter has an interest in any form of property in this State and has not provided an adequate power of attorney authorizing another to act in his behalf in regard to such property or interest, any person who would have an interest in the property or estate of the absentee in military service were such absentee in military service deceased, or any person who is dependent on such absentee in military service for his maintenance or support, may commence an action for the appointment of a receiver to care for the estate of the absentee in military service by filing a verified complaint in the superior court in the county of domicile of the absentee in military service or in any county where his property is situated.

(b) The complaint shall show the following:

(1) The name, age, address, relationship of the person filing the complaint to the alleged absentee, and the interest of that person in the property of the absentee in military service or his dependency upon the absentee in military service for his maintenance and support.

(2) The name, age, and address of all persons who would have an interest in the estate of the absentee in military service were he deceased and the name, age, and address of all persons dependent upon him for their maintenance and support.

(3) The name, age, and last known address of the absentee in military service.

(4) The date on which the absentee in military service was first reported as missing or captured by the appropriate federal agency, and, as far as is known, the circumstances surrounding his absence.

(5) The necessity for and the reasons why a receiver should be appointed.

(6) Whether or not the person alleged to be an absentee in military service has a will and the whereabouts of said will.

(7) So far as known, a schedule of all his property within this State, including property in which he is co-owner with or without the right of survivorship. (1973, c. 522, s. 2.)

§ 28B-3. Notice; hearing; guardian ad litem.

(a) Notice of the hearing on the complaint to appoint a receiver shall be given to all persons named in the petition by registered mail or certified mail with return receipt requested.

(b) The judge shall hear evidence on the questions of whether the person alleged to be missing or captured is an absentee in military service as defined by G.S. 28B-1, on the question of the necessity for the appointment of a receiver, and on the question of who is entitled to appointment as the receiver.

(c) The court may in its discretion appoint a guardian ad litem to represent the alleged absentee in military service at the hearing. (1973, c. 522, s. 3.)

§ 28B-4. Order of appointment.

(a) If after the hearing, the court is satisfied that said person is, in fact, an absentee in military service as defined in G.S. 28B-1 and that it is necessary that a receiver be appointed, he shall appoint a receiver of the estate and property of said absentee in military service under the supervision and subject to the further orders of the court.

(b) In the appointment of a receiver, the court shall give due consideration to the appointment of the spouse or one of the next of kin of the absentee in military service if such spouse or next of kin is a fit and proper person and is qualified to act. (1973, c. 522, s. 4.)

§ 28B-5. Bond; inventory; accounting.

(a) Before receiving any property the judge shall require the receiver to qualify by giving bond in an amount and with surety approved by him.

(b) Within 30 days after the date of his appointment, the receiver shall file an inventory of all of the property of the absentee in military service taken in charge. Every year thereafter, within 30 days of the anniversary date of his appointment the receiver shall file a full and complete inventory and accounting with the clerk of superior court under oath, of the amount of property received by him, or invested by him, and the manner and nature of such investment, and his receipts and disbursements for the past year in the form of debit and credit. The clerk shall inspect and audit the inventory and accounting and if he approves the same he shall endorse his approval thereon, which shall be deemed prima facie evidence of correctness. If the clerk finds evidence of misconduct or default on the part of the receiver he shall report the same to the court. In such event, the procedures found in G.S. 28B-7(b) shall be followed. (1973, c. 522, s. 5.)

§ 28B-6. Powers and duties of receiver.

(a) Under the direction of a judge, the receiver shall administer the property of the absentee in military service as an equity receivership with the following powers:

(1) To take custody and control of all property of the absentee in military service wherever situated.
(2) To collect all debts due to the absentee in military service and pay all debts owed by him.
(3) To bring and defend suits.
(4) To pay insurance premiums.
(5) With the approval of the judge in each instance, to continue to operate and manage any business enterprise, farm or farming operations, and to make necessary contracts with reference thereto.

(6) With the approval of the judge in each instance, to renew notes and other obligations, obtain loans on life insurance policies, and pledge or mortgage property for loans necessary in carrying on or liquidating the affairs of such absentee in military service.

(7) With the approval of the judge in each instance, to institute proceedings to partition property owned by the absentee and another as joint tenants or tenants in common, with or without the right of survivorship; provided, in the case of property owned by the absentee in military service and spouse as tenants by the entirety, such proceedings may be instituted only if the spouse of the absentee in military service consents in writing to the partitioning, and, in the event of partitioning, one half of the property or proceeds shall belong to the spouse and one half shall belong to the receiver as property of the absentee in military service.

(8) With the approval of the judge in each instance, to sell, lease, invest, and reinvest any or all property, its income, or its proceeds.

(9) To pay over or apply the proceeds of mortgage and sales of such portion, or all of the property or the income thereof, as may be necessary for the maintenance and support of the dependents of the absentee in military service. If the income from the property of the absentee in military service is not sufficient to pay all of his debts and to provide for the maintenance and support of his dependents, the receiver may apply to the judge for an order to sell or mortgage so much of the real or personal property as may be necessary therefor. Such sale or mortgage shall be reported to the judge, and if approved and confirmed by the judge, the receiver shall execute the required conveyances or mortgages of such property to the purchaser or lender upon his complying with the terms of sale or mortgage.

(b) The judge may, in his discretion, by written order, modify, add to, or subtract from the statutory powers granted in this section. (1973, c. 522, s. 6.)

§ 28B-7. Resignation and removal.

(a) A receiver appointed under authority of this Chapter may resign and his successor be appointed by complying with the provisions set forth in G.S. 36-9 through 36-18.2.

(b) If, after a receiver has been appointed, it is made to appear to the court upon the filing of a complaint or upon information received that the person appointed as receiver of the estate and property of the absentee in military service is legally incompetent, or that such person has been guilty of default or misconduct in due execution of his office, or that his appointment was obtained by false representation, or that such person has removed himself from this State, the court shall issue an order requiring such person to show cause why his appointment as a receiver should not be revoked. Upon the removal of a receiver of the estate or property of an absentee in military service, the court shall immediately appoint his successor. Pending any suit or proceeding between parties respecting such revocation, the clerk of superior court is authorized to make such interlocutory orders as may tend to better secure the estate and property of the absentee in military service. (1973, c. 522, s. 7.)

Editor's Note. — Sections 36-9 through 36-18.2, referred to in subsection (a) of this section, were repealed by Session Laws 1977, c. 502, s. 1, effective January 1, 1978. For similar provisions, see now G.S. 36A-22 et seq.

§ 28B-8. Termination of receivership.

(a) At any time upon petition signed by the absentee in military service, or on petition of an attorney-in-fact acting under an adequate power of attorney granted by the absentee in military service, the court shall direct the termination of the receivership and the transfer of all property held thereunder to the absentee in military service or to the designated attorney-in-fact.

(b) If at any time subsequent to the appointment of a receiver it shall appear that the absentee in military service has died and an executor or administrator has been appointed for his estate, the court shall terminate the receivership, certify all proceedings under the receivership to the clerk of superior court, and transfer all property of the deceased absentee in military service held thereunder to such executor or administrator.

(c) When the need for a receivership terminates, the receiver shall promptly file a final inventory and accounting and his application for discharge with the court. If it appears to the court that the inventory and accounting are correct and that the receiver has made full and complete transfer of the assets of the absentee in military service as directed, the court may approve the inventory and accounting and discharge the receiver. If objections to the final inventory and accounting are filed, the court shall conduct a hearing under the same conditions for a hearing on objections to the annual accounting and inventory.

(d) Such discharge shall operate as a release from the duties of the receivership and as a bar to any suit against said receiver or his surety, unless such suit is commenced within one year from the date of discharge. (1973, c. 522, s. 8.)

§ 28B-9. Specific property valued at less than $5,000; summary procedure.

(a) If the spouse of any person defined as an absentee in military service by this Chapter, or his next of kin, if said absentee in military service has no spouse, shall wish to sell or transfer any property of the absentee in military service which has a gross value of less than five thousand dollars ($5,000), or shall require the consent of the absentee in military service in any matter regarding the children of the absentee in military service, or in any other matter in which the gross value of the subject matter is less than five thousand dollars ($5,000), such spouse may apply to the superior court for an order authorizing said sale, transfer, or consent without opening a full receivership proceeding as provided by this Chapter. Said application shall be made by petition on the following form, which form shall be made available to the applicant by the clerk of the superior court:

STATE OF NORTH CAROLINA
________________ COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION

In re: *(absentee),* PETITION FOR SUMMARY APPOINTMENT OF RECEIVER NOW COMES, *(name of petitioner),* petitioner in this action, pursuant to G.S. ____________, and requests the Court that he be appointed a receiver to sell/transfer *(describe property)* of the value of *(value)* because *(give reasons).* Petitioner is ________ years of age, resides at *(address)* in ________________ County, North Carolina, and is the *(relation)* of *(name of absentee)* who has been *(pow or mia)* since *(date of notification).* The terms of the sale/transfer are *(terms).* Petitioner requires the consent of the absentee for the purpose of *(give reasons).*

(Signature) ____________________.

The above named, ________________, being by me duly sworn, says the foregoing petition is true and correct to the best of his knowledge.

____
Notary Public
My commission expires __________

(b) The court shall, without hearing or notice, enter an order on said petition if it deems the relief requested in said petition necessary to protect the best interest of the absentee in military service or his dependents.

(c) Such order shall be prima facie evidence of the validity of the proceedings and the authority of the petitioner to make a conveyance or transfer property or to give the consent of the absentee in military service in any matter prescribed by subsection (a). (1973, c. 522, s. 9.)

§ 28B-10. Specific property valued at more than $5,000; summary procedure.

(a) If the spouse, or the next of kin if there is no spouse, of any person defined as an absentee in military service under this Chapter shall wish to sell, lease, or mortgage specific property having a gross value of five thousand dollars ($5,000) or more owned by the absentee in military service or in which the absentee has an interest, or take specific action with respect to any interest of the absentee in military service having a gross value of five thousand dollars ($5,000) or more, such spouse may file a complaint with the superior court for an order authorizing the action with respect to such property or interest.

(b) The complaint shall contain all of the information called for by G.S. 28B-2(b) and, in addition, shall contain a description of the specific property or interest and the disposition to be made of it.

(c) The court shall hear evidence on the question of whether the person alleged to be missing or captured is an absentee in military service as defined by G.S. 28B-1 and on the question of whether the action in question should be authorized. Any person interested in such proceedings may intervene with leave of the court.

(d) The court may in its discretion appoint a guardian ad litem to represent the alleged absentee in military service at the hearing.

(e) If, after hearing, the court is satisfied that the person alleged to be an absentee in military service is, in fact, an absentee in military service as defined in G.S. 28B-1, and that the action is in the best interest of the absentee in military service and his dependents, the court shall enter an order appointing the petitioner as receiver for the purposes of the specific action which is the subject of the complaint and authorizing the receiver to take the specific action requested in the complaint. The court shall require the receiver to account for the proceeds of the specific sale, the specific lease, or other specific action. The court may retain jurisdiction of the proceeding to make such further orders as it deems proper.

(f) Such order shall be prima facie evidence of the validity of the proceedings and the authority of the petitioner to take the specific action requested.

(g) Other property of the absentee in military service not the specific subject of the complaint is not affected in any manner by the filing of such complaint as provided for in this section. (1973, c. 522, s. 10.)

Chapter 28C.

Estates of Missing Persons.

Sec.
28C-1. Death not presumed from seven years' absence; exposure to peril to be considered.
28C-2. Action for receiver; contents of complaint; parties.
28C-3. Procedure on complaint.
28C-4. Notice to interested persons.
28C-5. Service of notices.
28C-6. Procedure after notice.
28C-7. Property transferred to permanent receiver by order of judge; filing of inventory; recordation of order of transfer.
28C-8. Powers and duties of permanent receiver.
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28C-14. Additional limitations on accounting, distribution or making claim by absentee.
28C-15. When claim of absentee barred.
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28C-20. Provisions applicable to person held incommunicado in foreign country.
28C-21. When agents' acts binding on estate of absentee.
28C-22. Provisions of Chapter severable.

Editor's Note. — This Chapter was originally codified as Chapter 28A. It was transferred and redesignated Chapter 28C by Session Laws 1973, c. 1329, s. 2. The same 1973 act repealed former Chapter 28, Administration, and enacted present Chapter 28A, Administration of Decedents' Estates.

Session Laws 1973, c. 1329, originally made effective July 1, 1975, was amended by Session Laws 1975, c. 19, s. 12, so as to make it effective as to estates of decedents dying on and after that date, and by Session Laws 1975, c. 118, so as to change the date to October 1, 1975.

§ 28C-1. Death not presumed from seven years' absence; exposure to peril to be considered.

(a) Death Not to Be Presumed from Mere Absence. — In any action under this Chapter, where the death of a person and the date thereof, or either, is in issue the fact that he has been absent from his place of residence, unheard of for seven years, or for any other period, creates no presumption requiring the judge or the jury to find that he is now deceased. The issue shall be decided by the judge as one of fact upon the evidence.

(b) Exposure to Specific Peril to Be Considered. — If during such absence the person has been exposed to a specific peril of death, this fact shall be considered by the judge; or if there be a jury, shall be sufficient evidence to be submitted to the jury. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

Legal Periodicals. — For article on estates of missing persons in North Carolina, see 44 N.C.L. Rev. 275 (1966).

§ 28C-2. Action for receiver; contents of complaint; parties.

(a) Action for Receiver to Be Instituted in the Superior Court. — If any person having an interest in any property in this State disappears and is absent from his place of residence and after diligent inquiry his whereabouts remains unknown to those persons most likely to know the same, for a period of 30 days or more, anyone who would be entitled to administer the estate of such absentee if he were deceased, or any interested person, may commence a civil action and file a duly verified complaint in the superior court of either the county of such absentee's domicile, or the county where any of his property is situated.

(b) Contents of the Complaint. — The complaint shall contain the following:

(1) The name, age, occupation, and last known residence or address of such absentee;

(2) The date and circumstances of his disappearance;

(3) So far as known, a schedule of all his property within this State, including property in which he has an interest as tenant by the entirety, and other property in which he is co-owner with or without the right of survivorship;

(4) The names and addresses of the person who would have an interest in the estate of such absentee if he were deceased;

(5) The names and addresses of all persons known to the complainant to claim an interest in the absentee's property; and

(6) A prayer, that ancillary to the principal action, a receiver be appointed by virtue of the provisions of this Chapter to take custody and control of such property of the absentee and to preserve and manage the same pending final disposition of the action as provided in G.S. 28C-11.

(c) Parties to the Action. — The absentee, all persons who would have an interest in the estate of such absentee if he were deceased, all persons known to claim an interest in the absentee's property, and all known insurers of the life of the absentee shall be made parties to the action. A guardian ad litem shall be appointed for the absentee, and shall file an answer in his behalf. (1965, c. 815, s. 1; 1973, c. 522, s. 11; c. 1329, s. 2.)

Cross References. — As to estates of prisoners of war and persons declared missing in action, see Chapter 28B.

Legal Periodicals. — For note on requirement of notice for appointment of guardians ad litem and next friends, see 48 N.C.L. Rev. 92 (1969).

§ 28C-3. Procedure on complaint.

Upon the filing of the complaint referred to in G.S. 28C-2, the judge may for cause shown appoint a temporary receiver to take charge of the property of the absentee to conserve it pending hearing on the complaint. Such temporary receiver shall qualify by giving bond in an amount and with surety approved by the judge and shall exercise only the powers specified by the judge. Within 30 days after the date of his appointment, he shall file an inventory of the property taken in charge. If a permanent receiver is appointed, the temporary receiver shall transfer and deliver to the permanent receiver all property in his custody and control, less such only as may be necessary to cover his expenses and compensation as allowed by the judge, and shall file his final account, and upon its approval be discharged. If the prayer for a permanent receiver is denied, the temporary receiver shall transfer and deliver to those entitled thereto all property in his custody and control less such only as may be necessary to cover his expenses and compensation as allowed by the judge, and shall file his final account, and upon its approval be discharged. If the prayer for a permanent receiver is denied the expenses and compensation of the temporary receiver may in the discretion of the judge be taxed as costs of the action to be paid by the complainant, but if the judge finds that the complaint was brought in good faith and upon reasonable grounds, he may charge such costs against the property of the absentee. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-4. Notice to interested persons.

Upon the filing of the inventory by the temporary receiver, the judge shall issue a notice reciting the substance of the complaint and the appointment and action of the temporary receiver. This notice shall be addressed to such absentee, to all persons who would have an interest in the estate of such absentee if he were deceased, to all persons alleged in the complaint to claim an interest in the absentee's property, and to all whom it may concern. It shall direct them to file in the court within a time fixed by the judge a written statement of the nature and extent of the interest claimed in the property, and to appear at a time and place named and show cause why a permanent receiver of the absentee's property should not be appointed to hold and dispose of the property under the provisions of this Chapter. The return day of the notice shall be not less than 30 nor more than 60 days after its date unless otherwise ordered by the judge. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-5. Service of notices.

All notices required under this Chapter shall be served on all parties to the action and on all other persons entitled to such notice in the manner now prescribed by Rules of Civil Procedure, and in addition thereto the absentee shall be served by publication once in each of four successive weeks in one or more newspapers in the county where the proceeding is pending, and one copy shall be posted in a conspicuous place upon each parcel of land shown in the temporary receiver's inventory, and one copy shall be sent by registered or certified mail with return receipt requested to the last known address of such absentee. The judge may in his discretion cause other and further notice to be given within or without the county. (1965, c. 815, s. 1; 1973, c. 1329, s. 2; 1981, c. 682, s. 8.)

Cross References. — As to service of pleadings and other papers, see G.S. 1A-1, Rule 5. As to service of subpoena, see G.S. 1A-1, Rule 45.

Editor's Note. — The Rules of Civil Procedure, referred to in this section, are found in G.S. 1A-1.

§ 28C-6. Procedure after notice.

The absentee or any person entitled to notice as provided in G.S. 28C-4 may appear and show cause why a permanent receiver of the absentee's property should not be appointed to hold and dispose of the property under the provisions of this Chapter. The judge may, after the hearing, either dismiss the complaint and order that the property in the custody and control of the temporary receiver be returned to the persons entitled thereto or he may make a finding that the absentee disappeared as of a stated date and appoint a permanent receiver of the absentee's property. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-7. Property transferred to permanent receiver by order of judge; filing of inventory; recordation of order of transfer.

Upon the permanent receiver giving bond as required by G.S. 28C-16 and its approval by the judge, the judge shall order the temporary receiver to transfer and deliver to the permanent receiver custody and control of the absentee's property, and the permanent receiver shall file with the court an inventory of the property received by him. A copy of this order as it affects any real property shall be issued by the judge and delivered to the permanent receiver who shall cause the same to be recorded in the office of the register of deeds of each county wherein such real property is situated. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-8. Powers and duties of permanent receiver.

The permanent receiver shall under the direction of the judge administer the absentee's property as an equity receivership with the following powers:

(1) To take custody and control of all property of the absentee wherever situated,

(2) To collect all debts due to the absentee and to pay all debts owed by him,

(3) To bring and defend suits,

(4) To pay insurance premiums,

(5) With the approval of the judge in each instance, to continue to operate and manage any business enterprise, farm or farming operations, and to make necessary contracts with reference thereto,

(6) With the approval of the judge in each instance, to renew notes and other obligations, obtain loans on life insurance policies, and pledge or mortgage property for loans necessary in carrying on or liquidating the affairs of such absentee,

(7) With the approval of the judge in each instance, to partition property owned by the absentee and another as joint tenants or tenants in common, with or without the right of survivorship; provided, in the case of property owned by the absentee and spouse as tenants by the entirety, such property may be partitioned only if the absentee's spouse consents in writing to the partitioning, and, in the event of partitioning, one half of the property or proceeds shall belong to the spouse and one half shall belong to the receiver as property of the absentee,

(8) With the approval of the judge in each instance to sell, lease, invest and reinvest any or all property, its income, or its proceeds,

(9) To pay over or apply the proceeds of loans and sales of such portion, or all of the property or the income thereof as may be necessary for the maintenance and support of the absentee's dependents; and if the income from the property of the absentee is not sufficient to pay all his debts and to provide for the maintenance and support of his dependents, the permanent receiver may apply to the judge for an order to sell or mortgage so much of the real or personal property as may be necessary therefor; each such sale or mortgage shall be reported to the judge, and if approved and confirmed by the judge, the receiver shall execute the required conveyances or mortgages of such property to the purchaser or lender upon his complying with the terms of sale or mortgage.

The judge may, in his discretion, by written order modify, add to or subtract from the statutory powers granted in this section. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-9. Search for absentee.

The judge shall by order direct the receiver to make a search for the absentee. The order shall specify the manner in which the search is to be conducted in order to insure that, in the light of the circumstances of the particular case, a diligent and reasonable effort be made to locate the absentee. The order may prescribe any methods of search deemed advisable by the judge, but must require, as a minimum, the following:

(1) Inquiry of persons at the absentee's home, his last known residence, the place where he was last known to have been, and other places where information would likely be obtained or where the absentee would likely have gone;

(2) Inquiry of relatives, friends and associates of the absentee, or other persons who should be most likely to hear from or of him;

(3) Insertion of a notice in one or more appropriate papers, periodicals or other news media, requesting information from any person having knowledge of the absentee's whereabouts; and

(4) Notification of local, state and national offices which should be most likely to know or learn of the absentee's whereabouts. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-10. Claims against absentee.

Immediately upon the appointment of a permanent receiver under this Chapter, the permanent receiver shall publish a notice addressed to all persons having claims against the absentee informing them of the action taken and requiring them to file their claims under oath with the permanent receiver. If any claimant fails to file his sworn claim within six months from the date of the first publication of such notice, the receiver may plead this fact in bar of his claim. Such notice shall be published in the same manner as that now prescribed by statute (G.S. 28-47) for claims against the estate of a decedent. Any party in interest may contest the validity of any claim before the judge, on due notice given to the permanent receiver and the person whose claim is contested. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

Editor's Note. — Section 28-47, referred to in the section above, was repealed by Session Laws 1973, c. 1329, s. 1. For present provisions as to advertisement of claims, see G.S. 28A-14-1.

§ 28C-11. Final finding and decree.

(a) At any time, during the receivership proceedings, upon application to the judge by any party in interest and presentation of satisfactory evidence of the absentee's death, the judge may make a final finding and decree that the absentee is dead; in which event the decree and transcript of all of the receivership proceedings shall be certified to the clerk of the superior court for any administration as may be required by law upon the estate of a decedent, and the judge shall proceed no further except for the purposes hereinafter set forth in G.S. 28C-12, subdivisions (1) and (4); or

(b) At any time during the receivership proceedings, upon application to the judge by any party in interest and presentation of satisfactory evidence of the absentee's existence and whereabouts, except as provided in G.S. 28C-20, the judge may be decree revoke his finding that he is an absentee, and the judge shall proceed no further except for the purposes hereinafter set forth in G.S. 28C-12, subdivisions (2) and (4); or

(c) After the lapse of five years from the date of the finding of disappearance provided for in G.S. 28C-6, if the absentee has not appeared and no finding and decree have been made in accordance with the provisions of either subsections (a) or (b) above, and subject to the provisions of G.S. 28C-14, the judge may proceed to take further evidence and thereafter make a final finding of such absence and enter a decree declaring that all interest of the absentee in his property, including property in which he has an interest as tenant by the entirety and other property in which he is co-owner with or without the right of survivorship, subject to the provisions of G.S. 28C-8(7), has ceased and devolved upon others by reason of his failure to appear and make claim. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-12. Termination of receivership.

Upon the entry of any final finding and decree as provided in G.S. 28C-11, the judge shall proceed to wind up the receivership and terminate the proceedings:

(1) In the case of a decree under G.S. 28C-11, subsection (a), that the absentee is dead:
  a. By satisfying all outstanding expenses and costs of the receivership, and
  b. By then deducting for the insurance fund provided in G.S. 28C-19 a sum equal to five percent (5%) of the total value of the property remaining for distribution upon settlement of the absentee's estate, including amounts paid to the estate from policies of insurance on the absentee's life, and
  c. By then certifying the proceedings to the clerk of the superior court subject to an order by the judge administering the receivership, or

(2) In the case of a decree under G.S. 28C-11, subsection (b), revoking the finding that the missing person is an absentee:
  a. By satisfying all outstanding expenses and costs of the receivership, and
  b. By then returning his remaining property to him and rendering an accounting for that property not returned; or

(3) In the case of a decree under G.S. 28C-11, subsection (c), declaring that all interest of the absentee in his property has ceased:
  a. By satisfying all outstanding expenses and costs of the receivership, and
  b. By then satisfying all outstanding taxes, other debts and charges, and
  c. By then deducting for the insurance fund provided in G.S. 28C-19 a sum equal to five percent (5%) of the total value of the property remaining, including amounts paid to the receivership estate from policies of insurance on the absentee's life, and
  d. By transferring or distributing the remaining property as provided in G.S. 28C-13; and

(4) In all three cases by requiring the receiver's account, and upon its approval, discharging him and his bondsmen and entering a final decree terminating the receivership. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-13. Distribution of property of absentee.

The property remaining for distribution in accordance with the provisions of G.S. 28C-12, subdivision (3)d shall be transferred or distributed by the receiver and in accordance with the judge's decree to those persons who would be entitled thereto under the applicable laws of intestate succession as though the absentee died intestate on the day five years after the date of his disappearance as determined by the judge in his final finding and decree; or, if the absentee leaves a document which, had he died, might have been admissible to probate as his will, the judge administering the receivership shall cause citations to issue to all persons entitled to notice upon the probate of wills in solemn form and determine whether the will would have been admitted to probate, and, if it shall be so determined, the transfer and distribution shall be according to the provisions of the document as of the date of the decree under G.S. 28C-12, subdivision (3)d, subject, however, to the right of the spouse of such absentee, or others, to claim whatever property they would have been entitled by law to claim in derogation of the terms of the will as if the absentee had actually died testate on the date five years after the date of his disappearance as determined by the judge in his final finding and decree. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-14. Additional limitations on accounting, distribution or making claim by absentee.

If, at the time of the hearing in G.S. 28C-6 wherein a permanent receiver is appointed by the judge after a finding of disappearance as of a stated date, the date of disappearance so found is more than four years prior to the date of such hearing, the time limited for accounting for or fixed for transferring or distributing the property or its proceeds, or for barring actions by or on behalf of the absentee relative thereto, shall be not less than two years after the date of the appointment of the permanent receiver instead of the five years provided in G.S. 28C-11(c).

Provided, however, that the time limited for accounting for or fixed for transferring and distributing any additional property or its proceeds within the State coming into the custody and control of the permanent receiver during such two-year period, or for barring actions by or on behalf of the absentee relative thereto, shall be not more than one year after the expiration of said two-year period. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-15. When claim of absentee barred.

No action shall be brought by an absentee to recover any portion of the property which is the subject of this proceeding after a final finding and decree as provided for in G.S. 28C-11(a) or 28C-11(c). (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-16. Laws of administration of estates applicable.

Except as otherwise provided in this Chapter, the laws of this State applicable to administration of decedents' estates as to the amount and type of bond, inventories, reports, priority of creditors, compensation and court costs shall govern receivers appointed under this Chapter. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-17. Appointment of public administrator as receiver for estate of less than $1,000.

Whenever a receiver is to be appointed under this Chapter, and it is found by the judge that the fair value of the estate involved is less than one thousand dollars ($1,000), the judge shall appoint the public administrator as such receiver, if there be one for the county. In case such public administrator is appointed, he shall act as receiver under his official bond as public administrator which shall be liable for any default, and no other bond shall be required. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-18. Payment of insurance policies.

(a) At the time of the distribution under G.S. 28C-13 the judge may direct the payment of any sums as they become due on any policies of insurance upon the life of the absentee, to the proper parties as their interest may appear.

(b) If the insurer refuses payment, the judge, upon the finding of appropriate supplemental pleadings in the pending action, shall determine all issues arising upon the pleadings, provided that all issues of fact shall be tried by a jury, unless trial by jury is waived.

(c) Where the required survival of a beneficiary is not established the provisions of this Chapter shall apply as if the proceeds of the insurance were a part of the estate of the absentee, unless the absentee retained no interest in the policy.

(d) If in any proceeding under subsection (b) it is determined that the absentee is not dead and the policy provides for a surrender value, the receiver or an otherwise entitled beneficiary acting through the receiver, may demand the payment of the surrender value or obtain a policy loan. The receiver's receipt for such payment of surrender value shall be a release to the insurer of all claims under the policy. The receiver shall pay over to such beneficiary any money so received, first reserving only an amount allowed by the judge as costs of the proceedings under this section and that amount required by G.S. 28C-12(3)b. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-19. Absentee Insurance Fund.

(a) In each case of termination of the receivership, as provided in G.S. 28C-12, subdivisions (1) and (3), the judge shall set aside the sum therein named for the Absentee Insurance Fund and direct its payment by the receiver to the Treasurer of the State, who shall be liable therefor upon his official bond as for other moneys received by him in his official capacity.

(b) The Treasurer shall retain, invest and reinvest all funds thus paid in a separate account entitled the "Absentee Insurance Fund," and add thereto as received the interest or other earnings.

(c) If at any time thereafter, a person declared an absentee whose estate has been distributed under a final finding and decree made as provided in G.S. 28C-13 shall personally appear before the Treasurer and make claim for reimbursement from such fund, the superior court may in an action commenced in the Superior Court of Wake County by such person against the Treasurer, enter a judgment ordering payment to the claimant of such part of the accumulated fund from all sources as in its opinion is found to be fair, adequate and reasonable under the circumstances, taking into account the disposition made of his property, the reasons for his absence, and any other relevant matters.

(d) An action for compensation from the Absentee Insurance Fund shall be begun within three years from the time of the absentee's return. In cases of infancy or other disability recognized by law, persons under such disability shall have one year after the removal of such disability within which to begin the action.

(e) The Treasurer of the State shall from time to time prescribe the rate to be charged for the "Absentee Insurance Fund" under G.S. 28C-12, subdivisions (1) and (3) on the basis of actuarial experience. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-20. Provisions applicable to person held incommunicado in foreign country.

As to a person who is known to be held incommunicado in a foreign country, G.S. 28C-1 through 28C-8 and 28C-10 may be applied as though such person were an absentee within the meaning of this Chapter, and if his whereabouts becomes unknown, the other provisions of this Chapter may be applied by such amendments to the pending proceeding as may be required. This section shall not apply to personnel serving in or with the armed forces, the merchant marine, or the Red Cross during a period of hostilities between the United States and some other power who are listed by the appropriate federal agency as prisoners of war or as missing in action. (1965, c. 815, s. 1; 1973, c. 522, s. 12; c. 1329, s. 2.)

Cross References. — As to estates of prisoners of war and persons declared missing in action, see Chapter 28B, G.S. 28B-1 et seq.

§ 28C-21. When agents' acts binding on estate of absentee.

Acts of an agent of an absentee, carried out in good faith, prior to the appointment of a receiver under this Chapter, shall be binding on the estate of such absentee if said acts were within the scope of the agent's real or apparent authority. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

§ 28C-22. Provisions of Chapter severable.

If any provisions of this Chapter or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of this Chapter which can be given effect without the invalid provision or application, and to this end the provisions of this Chapter are declared to be severable. (1965, c. 815, s. 1; 1973, c. 1329, s. 2.)

Chapter 29.

Intestate Succession.

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ARTICLE 1.

General Provisions.

§ 29-1. Short title.

This Chapter shall be known and may be cited as the Intestate Succession Act. (1959, c. 879, s. 1.)

Editor's Note. — Session Laws 1959, c. 879, s. 1 inserted this present Chapter numbered 29 and entitled "Intestate Succession" to replace former Chapter 29 entitled "Descents." By the same act G.S. 28-149, with regard to order of distribution, was repealed and other related statutory provisions were repealed or amended to conform with the new Intestate Succession Law. Section 15 of the 1959 act provides: "This act shall become effective July 1, 1960, and shall be applicable only to estates of persons dying on or after July 1, 1960."

Some of the cases cited in the notes to the sections of this Chapter construe similar provisions of the former Chapter.

Section 4.1 of Session Laws 1963, c. 1209, provides that from and after the certification of the constitutional amendment to G.S. 6 of Art. X (see now N.C. Const. Art. X, G.S. 4) which was proposed by c. 1209, wherever the word "spouse" appears in the General Statutes with reference to testate or intestate successions, it shall apply alike to both husband and wife. The approval of the amendment by vote of the people was certified by the Governor on February 6, 1964.

Legal Periodicals. — For article, "North Carolina's New Intestate Succession Act," see 39 N.C.L. Rev. 1 (1960).

For comment on 1959 changes in intestate succession statutes, see 40 N.C.L. Rev. 297 (1962).

For note, "Does North Carolina Law Adequately Protect Surviving Spouses?" see 48 N.C.L. Rev. 361 (1970).

For note discussing the limitation on collateral inheritance in North Carolina, see 14 Wake Forest L. Rev. 1085 (1978).

For survey of 1979 tax law, see 58 N.C.L. Rev. 1548 (1980).

For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

For article, "Requiem for the Rule in Shelley's Case," see 67 N.C.L. Rev. 681 (1989).

For comment, "In re Estate of Lunsford and Statutory Ambiguity: Trying to Reconcile Child Abandonment and the Intestate Succession Act," 81 N.C.L. Rev. 1149 (2003).

CASE NOTES

Editor's Note. — *Some of the cases below were decided under prior law.*

Purpose of Chapter. — Taken as a whole, this Chapter conveys an intent by the legislature to write a reasonable will for those residents who have not done so. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Descents are regulated by statute in this State. Edwards v. Yearby, 168 N.C. 663, 85 S.E. 19 (1915); University of N.C. v. Markham, 174 N.C. 338, 93 S.E. 845 (1917).

English Canons of Descent Formerly Followed. — The English canons of descent remained in force in North Carolina until 1784. Because certain provisions seemed repugnant to republican principles, the legislature was led to make the changes which distinguish this section from the English act. Clement v. Cauble, 55 N.C. 82 (1854).

Legislative Intent as to Effect of Adoption. — The General Assembly, on its own motion and also in response to judicial decisions, has, with every amendment and every rewrite of G.S. 48-23, evidenced its intent that by adoption the child adopted becomes legally a child of its new parents, and the adoption makes him legally a stranger to the bloodline of his natural parents. Crumpton v. Crumpton, 28 N.C. App. 358, 221 S.E.2d 390 (1976), aff'd, 53 N.C. App. 97, 281 S.E.2d 1 (1981).

Wrongful Death Beneficiaries Determined as of Time of Death. — The persons who, under the Intestate Succession Act, are entitled to the recovery in a wrongful death action are to be determined as of the time of the decedent's death. First Union Nat'l Bank v. Hackney, 266 N.C. 17, 145 S.E.2d 352 (1965).

Proof of the death of a person raises a presumption that such person died intestate. Collins v. R.L. Coleman & Co., 262 N.C. 478, 137 S.E.2d 803 (1964).

Cited in Chisholm v. Hall, 255 N.C. 374, 121 S.E.2d 726 (1961); Chappell v. Chappell, 260 N.C. 737, 133 S.E.2d 666 (1963); In re Peacock, 261 N.C. 749, 136 S.E.2d 91 (1964); Byers v. North Carolina State Hwy. Comm'n, 3 N.C. App. 139, 164 S.E.2d 535 (1968), aff'd, 275 N.C. 229, 166 S.E.2d 649 (1969); Baxter v. Jones, 14 N.C. App. 296, 188 S.E.2d 622 (1972); Rodman v. Rodman, 21 N.C. App. 397, 204 S.E.2d 695 (1974); Wake County ex rel. Carrington v. Townes, 53 N.C. App. 649, 281 S.E.2d 765 (1981); Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754 (1983); In re Estate of Finch, 97 N.C. App. 489, 389 S.E.2d 126 (1990).

§ 29-2. Definitions.

As used in this Chapter, unless the context otherwise requires, the term:

(1) "Advancement" means an irrevocable inter vivos gift of property, made by an intestate donor to any person who would be his heir or one of his heirs upon his death, and intended by the intestate donor to enable the donee to anticipate his inheritance to the extent of the gift; except that no gift to a spouse shall be considered an advancement unless so designated by the intestate donor in a writing signed by the donor at the time of the gift.

(2) "Estate" means all the property of a decedent, including but not limited to:

a. An estate for the life of another; and

b. All future interests in property not terminable by the death of the owner thereof, including all reversions, remainders, executory interests, rights of entry and possibilities of reverter, subject, however, to all limitations and conditions imposed upon such future interests.

(3) "Heir" means any person entitled to take real or personal property upon intestacy under the provisions of this Chapter.

(4) "Lineal descendants" of a person means all children of such person and successive generations of children of such children.

(5) "Net estate" means the estate of a decedent, exclusive of family allowances, costs of administration, and all lawful claims against the estate.

(6) "Share," when used to describe the share of a net estate or property which any person is entitled to take, includes both the fractional share of the personal property and the undivided fractional interest in the real property, which the person is entitled to take. (1959, c. 879, s. 1; 1961, c. 958, s. 1.)

Cross References. — As to meaning of "next of kin," see G.S. 41-6.1.

Legal Periodicals. — For article, "The Rule Against Perpetuities in North Carolina," see 57 N.C.L. Rev. 727 (1979).

For survey of 1979 property law, see 58 N.C.L. Rev. 1509 (1980).

For note on a surviving spouse's right to dissent, see 16 Wake Forest L. Rev. 251 (1980).

For survey of 1980 property law, see 59 N.C.L. Rev. 1209 (1981).

For article, "Class Gifts in North Carolina — When Do We 'Call The Role'?," see 21 Wake Forest L. Rev. 1 (1985).

For article, "Does the Fee Tail Exist in North Carolina?," see 23 Wake Forest L. Rev. 767 (1988).

For a comment on the acquisition, abandonment, and preservation of rail corridors in North Carolina, see 75 N.C.L. Rev. 1989 (1997).

CASE NOTES

I. General Consideration.
II. Advancement.
III. Estate.
IV. Net Estate.
V. Share.
VI. Heirs.
VII. Lineal Descendants.
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I. GENERAL CONSIDERATION.

Cited in Dudley v. Staton, 257 N.C. 572, 126 S.E.2d 590 (1962); Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977); Avery v. Haddock, 68 N.C. App. 452, 315 S.E.2d 99 (1984); Elliot v. Cox, 100 N.C. App. 536, 397 S.E.2d 319 (1990); In re Estate of Bryant, 116 N.C. App. 329, 447 S.E.2d 468 (1994).

II. ADVANCEMENT.

Whether a gift is an advancement depends on the intention of the parent at the time the gift is made. Parrish v. Adams, 10 N.C. App. 700, 179 S.E.2d 880 (1971).

Knowledge That Conveyance Represents an Advancement Estops Claim to Any Other Lands. — Where a child accepts a deed with knowledge that the lands conveyed therein represent an advancement of his full share of the parents' realty, he is estopped to claim any other lands owned by the parents at the time of their deaths. Parrish v. Adams, 10 N.C. App. 700, 179 S.E.2d 880 (1971).

III. ESTATE.

"Estate" Defined. — Estate of a decedent includes all property owned by decedent which she may direct to her legatees and devisees under will and which would pass to her heirs and next of kin under laws of intestacy if she died without will. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

The distinction between a vested and a contingent remainder is the capacity to take upon the termination of the preceding estate. Strickland v. Jackson, 259 N.C. 81, 130 S.E.2d 22 (1963).

Where those who are to take in remainder cannot be determined until the happening of a stated event, the remainder is contingent. Strickland v. Jackson, 259 N.C. 81, 130 S.E.2d 22 (1963).

Estate Tail Distinguishable from Life Estate with Remainder. — Inasmuch as an estate tail is an estate of inheritance which descends to particular heirs, it is distinguishable from a life estate with remainder. Strickland v. Jackson, 259 N.C. 81, 130 S.E.2d 22 (1963).

IV. NET ESTATE.

Computation of Net Estate. — To ascertain "net estate" under subdivision (5) it is necessary to subtract from the value of the gross estate, "family allowances, costs of administration, and all lawful claims against the estate." Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Federal Estate Tax Is "Lawful Claim." — The federal estate tax is one of the "lawful claims" against testator's estate, and the widow's intestate share of the estate is to be computed after its deduction. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Legacies Not Excluded in Determining Net Estate. — The phrase "all lawful claims against the estate," as used in subdivision (5), does not include either specific legacies or general legacies for specific amounts. If it did, the net estate in many instances would be so deleted by their payment that it would be insufficient to provide the widow with the same share of her husband's real and personal property as if he died intestate. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

As Legacies or Distributive Shares Are Not "Lawful Claims." — In the use of the phrase "lawful claims against the estate" in subdivision (5), the legislature was not referring to claims of beneficiaries created either by the will or the statute of descents and distributions. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

Property Owned as Tenants by the Entirety. — The value of real property owned by couple as tenants by the entirety should not be included in testatrix's net estate for purposes of the dissent statute. In re Estate of Francis, 94 N.C. App. 744, 381 S.E.2d 484, cert. denied, 325 N.C. 708, 388 S.E.2d 456 (1989).

Residue of Net Estate after Distribution to Dissenting Widow. — When the dissenting widow was entitled to one half of the deceased spouse's net estate as defined in subdivision (5) of this section, former G.S. 30-3(c) said that the residue of the testator's net estate for distribution to other devisees and legatees was as defined in this section. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

V. SHARE.

Definition of "Share" Applies to Share of Net Estate. — The definition contained in subdivision (6) is intended to apply when "share" is used "to describe the share of a net estate or property," e.g., a share under G.S. 29-14, which "includes ... the undivided fractional interest in the real property." Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

VI. HEIRS.

Technical Construction of Term "Heirs." — Absent words expressing testatrix' contrary intent, the court would construe the word "heirs" in will in the technical sense. Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

Consideration of Laws in Effect at Time of Death. — In construing a will with a remainder interest to a class of the testatrix' "heirs," the courts look to the intestacy laws in effect at the testatrix' death to determine who the "heirs" are and the shares which they are entitled to take, unless the language of the will reveals a contrary intent. Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

For discussion of construction of the phrase "to my nearest (relatives) heirs" in the remainder clause of a devise by testatrix who died in May, 1962, see Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

VII. LINEAL DESCENDANTS.

Children Distinguished from Others. — The phrase "lineal descendants" generally applies not to distinguish between children of various marriages or out of wedlock, but to distinguish children from other collateral descendants, e.g., nieces and nephews. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Illegitimate and Adopted Children Included. — The term "lineal descendants" would include even illegitimate children of a deceased female, under G.S. 29-19(a), and clearly includes adopted children, under G.S. 29-17. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Children Adopted by Wife's Second Husband. — Children born to wife and her first husband became lineal descendants of her second husband upon his adoption of them because they became in law his children. In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

VIII. COSTS OF ADMINISTRATION.

Costs of administration, as used in subdivision (5) of this section, means those ordinary, usual, and necessary expenses of administering a decedent's estate; a will caveat and its expense is neither of these, for a will caveat is a claim that the will involved is invalid, and its expense is a cost of court taxable against either party, or apportioned among the parties, in the discretion of the court. In re Estate of Ward, 97 N.C. App. 660, 389 S.E.2d 441 (1990).

§ 29-3. Certain distinctions as to intestate succession abolished.

In the determination of those persons who take upon intestate succession there is no distinction:

(1) Between real and personal property, or
(2) Between ancestral and nonancestral property, or
(3) Between relations of the whole blood and those of the half blood. (1959, c. 879, s. 1.)

CASE NOTES

Distinctions Abolished Only for Purposes of Determining Succession. — This section abolishes the distinction between real and personal property only in the determination of those persons who take upon intestate succession. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

Applied in In re Johnston, 16 N.C. App. 38, 190 S.E.2d 879 (1972).

§ 29-4. Curtesy and dower abolished.

The estates of curtesy and dower are hereby abolished. (1959, c. 879, s. 1.)

Legal Periodicals. — For article, "Does the Fee Tail Exist in North Carolina?," see 23 Wake Forest L. Rev. 767 (1988).

CASE NOTES

Cited in Dudley v. Staton, 257 N.C. 572, 126 S.E.2d 590 (1962); Marlowe v. Clark, 112 N.C. App. 181, 435 S.E.2d 354 (1993); Watson v. Smoker, 138 N.C. App. 158, 530 S.E.2d 344, 2000 N.C. App. LEXIS 554 (2000).

§ 29-5. Computation of next of kin.

Degrees of kinship shall be computed as provided in G.S. 104A-1. (1959, c. 879, s. 1.)

Cross References. — As to meaning of "next of kin," see G.S. 41-6.1.

§ 29-6. Lineal succession unlimited.

There shall be no limitation on the right of succession by lineal descendants of an intestate. (1959, c. 879, s. 1.)

§ 29-7. Collateral succession limited.

There shall be no right of succession by collateral kin who are more than five degrees of kinship removed from an intestate; provided that if there is no collateral relative within the five degrees of kinship referred to herein, then collateral succession shall be unlimited to prevent any property from escheating. (1959, c. 879, s. 1.)

Legal Periodicals. — For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For note discussing the limitation on collateral inheritance in North Carolina, see 14 Wake Forest L. Rev. 1085 (1978).

CASE NOTES

Rights of collateral succession are limited to the descendants of the intestate's parents or grandparents. This section limits such succession to those persons who are within five degrees of kinship to the intestate, and the effect of the proviso engrafted upon this section is to provide for unlimited succession by collateral kinsmen descended from the intestate's parents or grandparents in the event there are no collateral kinsmen of the fifth degree in such lines of descent. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

The limitation upon collateral succession to heirs within five degrees of kinship to the intestate contained in this section is a limitation upon succession by heirs descended from parents or grandparents of the intestate. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Escheats Not Eliminated by Proviso of this Section. — This section at most imposes a limitation upon intestate succession, as defined in G.S. 29-15, and by its proviso restates the existing effect of G.S. 29-15, i.e., that collateral descent shall be unlimited when it is within the parentela of an intestate's parents or grandparents. Thus, in enacting this section, the legislature did not intend to eliminate escheats. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Effect of Section as to Escheat under § 29-12. — This section has no application to escheat under G.S. 29-12 unless the common ancestor of the collateral kin and the decedent is a parent or grandparent of the decedent. In such an event the main clause in this section operates to exclude a collateral kinsman of a sixth or higher degree from succeeding to the estate, even though he is a lineal descendent of the decedent's parents or grandparents. The proviso in this section, in order to prevent the escheat of the decedent's estate, provides for unlimited succession by collateral kinsmen who are descendants of the decedent's parents or grandparents when there is no such collateral kinsman within the fifth degree. Newlin v. Gill, 32 N.C. App. 392, 232 S.E.2d 213, aff'd, 293 N.C. 348, 237 S.E.2d 819 (1977).

§ 29-8. Partial intestacy.

If part but not all of the estate of a decedent is validly disposed of by his will, the part not disposed of by such will shall descend and be distributed as intestate property. (1959, c. 879, s. 1.)

CASE NOTES

Section Codifies Common Law. — This section, which was adopted in 1959, was a codification of the common law. Ferguson v. Croom, 73 N.C. App. 316, 326 S.E.2d 373 (1985).

Section Adopts Majority Rule. — The rule adopted by this section is also in accordance with the rule followed by a majority of the sister states. Ferguson v. Croom, 73 N.C. App. 316, 326 S.E.2d 373 (1985).

This section creates a mandatory plan for disposing of a decedent's property which does not pass by will. It directs that the property pass by intestate succession without regard to the intent expressed by a testator in a will. Ferguson v. Croom, 73 N.C. App. 316, 326 S.E.2d 373 (1985).

Presumption against partial intestacy is merely a rule of construction and cannot have the effect of transferring property in the face of contrary provisions in the will. The presumption must yield when outweighed by manifest and unequivocal intent. McKinney v. Mosteller, 321 N.C. 730, 365 S.E.2d 612 (1988).

Illustrative Case. — Where, as gleaned from will itself, the intent of the testator was that the residue of his estate was to pass to named beneficiaries under the residuary clause of the will only if testator's wife survived him, and she did not, the residue would pass to his heirs at law in accordance with the laws of intestacy as enacted by the legislature. McKinney v. Mosteller, 321 N.C. 730, 365 S.E.2d 612 (1988).

Where decedent did not provide a testamentary disposition of four parcels of land, either specifically or through a residuary clause, the land did not pass under decedent's will, but instead qualified as a partial intestacy. Tarlton v. Stidham, 122 N.C. 77, 469 S.E.2d 38 (1996).

§ 29-9. Inheritance by unborn infant.

Lineal descendants and other relatives of an intestate born within 10 lunar months after the death of the intestate, shall inherit as if they had been born in the lifetime of the intestate and had survived him. (1959, c. 879, s. 1.)

Legal Periodicals. — For article, "Class Gifts in North Carolina — When Do We 'Call The Roll'?," see 21 Wake Forest L. Rev. 1 (1985).

For note on the wrongful death of a viable fetus, see 23 Wake Forest L. Rev. 849 (1988).

CASE NOTES

Child Born after 10 Months. — If a child is born more than 10 lunar months or 280 days after the death of the intestate, the presumption is that the child was not en ventre sa mere when the intestate died, but this presumption may be rebutted by evidence tending to show that he was in fact the father of the child. Byerly v. Tolbert, 250 N.C. 27, 108 S.E.2d 29 (1959), decided under former Rule 7 of old § 29-1. See also Britton v. Miller, 63 N.C. 268 (1869); In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643.

§ 29-10. Renunciation.

Renunciation of an intestate share shall be as provided for in Chapter 31B of the General Statutes. (1959, c. 879, s. 1; 1961, c. 958, s. 2; 1975, c. 371, s. 2.)

CASE NOTES

A renunciation is not a grant of legal title by the renouncer. It merely triggers a set of statutorily defined legal rights which ultimately determine ownership. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under this section as it read prior to October 1, 1975.

A renunciation relates back to the death of the testator or intestate. The renouncer never actually holds legal title to the property. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under this section as it read prior to Oct. 1, 1975.

A parol trust may not be engrafted upon a renounced interest. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under this section as it read prior to Oct. 1, 1975.

Action Seeking Constructive Trust. — Plaintiff, who sought to assert that defendant unduly influenced his decision to sign a "Petition to Renounce" his interest in will, could maintain an action seeking the declaration of a constructive trust. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under this section as it read prior to Oct. 1, 1975.

Collateral Attack. — The legality of plaintiff's renunciation under this section as it read prior to Oct. 1, 1975, was a matter before the clerk, who, having exclusive original jurisdiction of the administration of testatrix's estate, allowed plaintiff's "Petition to Renounce." As a party to the original action, plaintiff could not later collaterally attack it. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under this section as it read prior to Oct. 1, 1975.

Cited in Brown v. Green, 3 N.C. App. 506, 165 S.E.2d 534 (1969).

§ 29-11. Aliens.

Unless otherwise provided by law, it shall be no bar to intestate succession by any person, that he, or any person through whom he traces his inheritance, is or has been an alien. (1959, c. 879, s. 1.)

§ 29-12. Escheats.

If there is no person entitled to take under G.S. 29-14 or G.S. 29-15, or if in case of an illegitimate intestate, there is no one entitled to take under G.S. 29-21 or G.S. 29-22 the net estate shall escheat as provided in G.S. 116B-2. (1959, c. 879, s. 1; 1961, c. 83; 1973, c. 1446, s. 7; 1999-456, s. 1; 1999-460, s. 8.)

Legal Periodicals. — For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For note discussing the limitation on collateral inheritance in North Carolina, see 14 Wake Forest L. Rev. 1085 (1978).

CASE NOTES

There is a distinction between derelict property and escheated property. An escheat occurs when the property owner dies intestate and without relatives descended from a common parent or grandparent. North Carolina State Treas. v. City of Asheville, 61 N.C. App. 140, 300 S.E.2d 283 (1983).

Presumption That Distant Relatives Not Included in Will. — Underlying this provision for escheat of the estate in the absence of certain relatives is a logical presumption that the intestate would not have included distant relatives in his will. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Effect of § 29-7 as to Escheat under This Section. — Section 29-7 has no application to escheat under this section unless the common ancestor of the collateral kin and the decedent is a parent or grandparent of the decedent. In such an event the main clause in G.S. 29-7 operates to exclude a collateral kinsman of a sixth or higher degree from succeeding to the estate, even though he is a lineal descendent of the decedent's parents or grandparents. The proviso in G.S. 29-7 in order to prevent the escheat of the decedent's estate provides for unlimited succession by collateral kinsmen who are descendants of the decedent's parents or grandparents when there is no such collateral kinsman within the fifth degree. Newlin v. Gill, 32 N.C. App. 392, 232 S.E.2d 213, aff'd, 293 N.C. 348, 237 S.E.2d 819 (1977).

Section 29-7 at most imposes a limitation upon intestate succession, as defined in G.S. 29-15, and by its proviso restates the existing effect of G.S. 29-15, i.e., that collateral descent shall be unlimited when it is within the parentela of an intestate's parents or grandparents. Thus, in enacting G.S. 29-7, the legislature did not intend to eliminate escheats. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Unrefunded ticket proceeds is neither abandoned nor derelict property. By purchasing a ticket to a concert, the ticket holder enters into a contract with the auditorium and the performer. If the contract is not performed, he or she may rescind the agreement and demand a refund, but is not compelled to do so. Nor must the auditorium operator or performer refund the purchase price absent a demand. If that were the case, the ticket holder would be unjustly enriched in retaining both money and memento. The auditorium is not a trustee of the unrefunded proceeds of the ticket sale; the auditorium is simply a party to an unperformed contract. North Carolina State Treas. v. City of Asheville, 61 N.C. App. 140, 300 S.E.2d 283 (1983).

ARTICLE 2.

Shares of Persons Who Take upon Intestacy.

§ 29-13. Descent and distribution upon intestacy; 120-hour survivorship requirement, revised simultaneous death act, Article 24, Chapter 28A.

(a) All the estate of a person dying intestate shall descend and be distributed, subject to the payment of costs of administration and other lawful claims against the estate, and subject to the payment of State inheritance or estate taxes, as provided in this Chapter.

(b) The determination of whether an heir has predeceased a person dying intestate shall be made as provided by Article 24 of Chapter 28A of the General Statutes. (1959, c. 879, s. 1; 1999-337, s. 5; 2007-132, s. 2.)

Editor's Note. — Session Laws 1999-337, s. 46, provides: "This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by this act before the effective date of its amendment or repeal; nor does it affect the right to any refund or credit of a tax that accrued under the amended or repealed statute before the effective date of its amendment or repeal."

Effect of Amendments. — Session Laws 2007-132, s. 2, effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, added "120-hour survivorship requirement, revised simultaneous death act, Article 24, Chapter 28A" in the section heading, designated the existing provisions as subsection (a), and added subsection (b).

CASE NOTES

The power of the legislature to determine who shall take the property of a person dying subsequent to the effective date of a legislative act cannot be doubted. Johnson v. Blackwelder, 267 N.C. 209, 148 S.E.2d 30 (1966).

Law at Time of Death Governs. — It is well settled that an estate must be distributed among heirs and distributees according to the law as it exists at the time of the death of the ancestor. Johnson v. Blackwelder, 267 N.C. 209, 148 S.E.2d 30 (1966).

Even Though Decedent Became Incompetent to Make Will Before Law Changed. — Where it was alleged that an intestate became mentally incapable of making a will prior to ratification of the Intestate Succession Act on June 10, 1959, and that such mental incapacity continued until his death, and it was contended that the intestate's personal estate should be distributed in accordance with the Intestate Succession Law as it existed on June 9, 1959, it was held that this contention assumes: Before he became mentally incapable of making a will, the intestate had knowledge of and was pleased with the statutes of descent and distribution; if he had made a will, he would have disposed of his estate as provided by the statutes then in effect; he would have been displeased with the provisions of the 1959 act; and, but for his mental incapacity, would have made a will disposing of his estate as provided by the statutes in effect prior to ratification of the 1959 act. Such successive assumptions underlying the contention are unwarranted. They relate to matters that lie wholly within the realm of speculation. The intestate had no vested right in the statutes of descent and distribution in effect prior to the ratification of the 1959 act. He was charged with knowledge that these statutes were subject to change by the General Assembly. Johnson v. Blackwelder, 267 N.C. 209, 148 S.E.2d 30 (1966).

Determinative fact is that the intestate made no will. Hence, his estate "shall descend and be distributed" in accordance with the statutes in effect on the date of his death, namely, this Chapter. Johnson v. Blackwelder, 267 N.C. 209, 148 S.E.2d 30 (1966).

Wife's right to dissent from her husband's will depends on whether she is entitled to take a widow's share of his estate under this section and G.S. 29-14. Sloop v. Sloop, 24 N.C. App. 295, 210 S.E.2d 262 (1974).

Wife Waived Right to Dissent from Will. — Where, by the terms of a deed of separation a wife released her right to take a widow's share of her husband's estate, she thereby waived her right to dissent from his will. Sloop v. Sloop, 24 N.C. App. 295, 210 S.E.2d 262 (1974).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

Intent to Release Share Implicit in Separation Agreement. — Where the intention of each party to the marriage to release his or her share in the estate of the other is implicit in the express provisions of their separation agreement, their situation and purpose at the time the instrument was executed, the law will imply release of rights under this section and specifically enforce the agreement. Lane v. Scarborough, 284 N.C. 407, 200 S.E.2d 622 (1973).

Provisions in a separation agreement that each would thereafter acquire, hold, and dispose of property as though unmarried and that each renounced the right to administer upon the estate of the other refuted the contention that one spouse intended to retain any rights in the other's estate. Lane v. Scarborough, 284 N.C. 407, 200 S.E.2d 622 (1973).

Wife May Be Administratrix Where Marital Relations Resumed. — Where, after the execution of a separation agreement and consent judgment between husband and wife, the wife returned to the marital home which she and her husband shared before the separation; thereafter the commissioners named in the consent judgment to sell the couple's joint property for division were instructed not to do so; the husband paid the wife's attorney for representing her in the litigation between them; and from the time the wife returned to the marital home until her husband's death, the husband and wife lived continuously in their marital residence, the wife was entitled to qualify as administratrix of the estate of her husband and share in his estate as his widow without prejudice by reason of the separation agreement and consent judgment. In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976).

Cited in Tolson v. Young, 260 N.C. 506, 133 S.E.2d 135 (1963); In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969); Long v. Coble, 11 N.C. App. 624, 182 S.E.2d 234 (1971).

§ 29-14. Share of surviving spouse.

(a) Real Property. — The share of the surviving spouse in the real property is:

(1) If the intestate is survived by only one child or by any lineal descendant of only one deceased child, a one-half undivided interest in the real property;

(2) If the intestate is survived by two or more children, or by one child and any lineal descendant of one or more deceased children or by lineal descendants of two or more deceased children, a one-third undivided interest in the real property;

(3) If the intestate is not survived by a child, children or any lineal descendant of a deceased child or children, but is survived by one or more parents, a one-half undivided interest in the real property;

(4) If the intestate is not survived by a child, children or any lineal descendant of a deceased child or children, or by a parent, all the real property.

(b) Personal Property. — The share of the surviving spouse in the personal property is:

(1) If the intestate is survived by only one child or by any lineal descendant of only one deceased child, and the net personal property does not exceed thirty thousand dollars ($30,000) in value, all of the personal property; if the net personal property exceeds thirty thousand dollars ($30,000) in value, the sum of thirty thousand dollars ($30,000) plus one half of the balance of the personal property;

(2) If the intestate is survived by two or more children, or by one child and any lineal descendant of one or more deceased children, or by lineal descendants of two or more deceased children, and the net personal property does not exceed thirty thousand dollars ($30,000) in value, all of the personal property; if the net personal property exceeds thirty thousand dollars ($30,000) in value, the sum of thirty thousand dollars ($30,000) plus one third of the balance of the personal property;

(3) If the intestate is not survived by a child, children, or any lineal descendant of a deceased child or children, but is survived by one or more parents, and the net personal property does not exceed fifty thousand dollars ($50,000) in value, all of the personal property; if the net personal property exceeds fifty thousand dollars ($50,000) in value, the sum of fifty thousand dollars ($50,000) plus one half of the balance of the personal property;

(4) If the intestate is not survived by a child, children, or any lineal descendant of a deceased child or children, or by a parent, all of the personal property.

(c) When an equitable distribution of property is awarded to the surviving spouse pursuant to G.S. 50-20 subsequent to the death of the decedent, the share of the surviving spouse determined under subsections (a) and (b) of this section shall be first determined as though no property had been awarded to the surviving spouse pursuant to G.S. 50-20 subsequent to the death of the decedent, and then reduced by the net value of the marital estate awarded to the surviving spouse pursuant to G.S. 50-20 subsequent to the death of the decedent. (1959, c. 879, s. 1; 1979, c. 186, s. 1; 1981, c. 69; 1995, c. 262, s. 3; 2001-364, s. 6.)

Legal Periodicals. — For note, "Does North Carolina Law Adequately Protect Surviving Spouses?" see 48 N.C.L. Rev. 361 (1970).

For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For note discussing the limitation on collateral inheritance in North Carolina, see 14 Wake Forest L. Rev. 1085 (1978).

For survey of 1979 property law, see 58 N.C.L. Rev. 1509 (1980).

For note on a surviving spouse's right to dissent, see 16 Wake Forest L. Rev. 251 (1980).

For article, "Class Gifts in North Carolina — When Do We 'Call The Roll'?," see 21 Wake Forest L. Rev. 1 (1985).

For recent development, "Death and the Partnership Principle: Interpreting Recent Abatement Amendments to North Carolina's Equitable Distribution Act," see 80 N.C.L. Rev. 1089 (2002).

CASE NOTES

This section defines the share of the surviving spouse of an intestate. Tolson v. Young, 260 N.C. 506, 133 S.E.2d 135 (1963); Peoples Oil Co. v. Richardson, 271 N.C. 696, 157 S.E.2d 369 (1967).

Words Describing Relationships Bear Ordinary Meanings. — In carefully naming the persons who take in cases of intestacy using words describing family relationships such as "parents," "brothers," "sisters," "grandparents," "aunts" and "uncles," the legislature intended that these words bear their ordinary and usual meaning. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

And Cannot Be Expanded. — The words "brother," "parent" and "grandparent" cannot be expanded to include other relationships such as "great-grandfather" or "great uncle." Therefore, the maxim, "Expressio unius est exclusio alterius" (the expression of one thing is the exclusion of another) tends to exclude collateral kin who are not in the parentela of the intestate's parents or grandparents. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Definition of "Share" in § 29-2(6) Applies. — The definition contained in G.S. 29-2(6) is intended to apply when "share" is used "to describe the share of a net estate or property," e.g., a share under this section which thus "includes ... the undivided fractional interest in the real property." Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

The intestate share does not include the value of property passing by survivorship (which includes property owned as tenants by the entirety), joint accounts with right of survivorship, and insurance payable to the surviving spouse. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

Estate Does Not Include Property Conveyed Away Prior to Death. — For purposes of this section a wife's husband's estate would not include property which he had conveyed away prior to his death, even though she had not joined in the conveyance. Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

A deed by plaintiff's husband, which was executed while he and plaintiff were living together and which conveyed his separate real property to his children by a prior marriage, was effective to convey title to the children free from any claims of plaintiff. Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

Insofar as concerns any rights which the spouse of a married person might acquire by virtue of the provisions of this section, the General Assembly has prescribed no regulation or limitations relating to the conveyance during lifetime by such married person of his or her separate real or personal property. Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

Present Right of Possession Not Conferred. — A wife is not a real party in interest so as to interpose as a defense or counterclaim, in an action in ejectment instituted by her husband's grantee, that her husband had fraudulently conveyed the lands without her joinder in order to deprive her of the possession thereof, since this section, defining the share of the surviving spouse of an intestate, and G.S. 29-30, providing for a life estate at the election of the surviving spouse, do not give her a present right of possession. Peoples Oil Co. v. Richardson, 271 N.C. 696, 157 S.E.2d 369 (1967).

Surviving Wife and Child Each Take Undivided One Half of Lands. — Upon the death of an intestate, title to his lands immediately vests in his wife and child under this section, each taking a one-half undivided interest in fee. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Share of Second or Successive Spouse. — Former G.S. 30-3(b), which provided that a second or successive spouse who dissented from the will of his deceased spouse should take only one half the amount provided by the Intestate Succession Act for the surviving spouse if the testator had surviving him lineal descendants by a former marriage but there were not surviving lineal descendants by the second or successive marriage, was not arbitrarily discriminatory and capricious so as to be violative of the due process provisions of the federal and State Constitutions. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

Absence of Lineal Descendants. — There being no lineal descendants, under this section the surviving widow is entitled to "all the net estate" of an intestate. Johnson v. Blackwelder, 267 N.C. 209, 148 S.E.2d 30 (1966).

Where decedent was not survived by a child, children, or any lineal decedent of a deceased child or children, or by a parent, surviving spouse was proper recipient of remainder interest in four parcels of land that passed as partial intestacy. Tarlton v. Stidham, 122 N.C. App. 77, 469 S.E.2d 38 (1996).

Wife's right to dissent from her husband's will depends on whether she is entitled to take a widow's share of his estate under G.S. 29-13 and this section. Sloop v. Sloop, 24 N.C. App. 295, 210 S.E.2d 262 (1974).

Wife Waived Right to Dissent from Will. — Where by the terms of a deed of separation a wife released her right to take a widow's share of her husband's estate, she thereby waived her right to dissent from his will. Sloop v. Sloop, 24 N.C. App. 295, 210 S.E.2d 262 (1974).

Distribution of Estate When Surviving Spouse Dissents from Will. — When a surviving spouse dissents from a will, the intestate share should be allocated so as to cause the least possible disruption of the decedent's plan for the distribution of his estate. In partitioning testatrix's property, her will should be given consideration, and insofar as possible the beneficiaries of the will should receive the property testatrix intended for them to receive. In re Estate of Etheridge, 33 N.C. App. 585, 235 S.E.2d 924, cert. denied, 293 N.C. 253, 237 S.E.2d 535 (1977).

This section does not purport to give a dissenting spouse the right to select the particular property he or she will receive in opposition to the dominant intent expressed in a will. The dominant intent expressed in the will is still controlling so long as it can be carried out and leave the dissenting spouse with the prescribed interest in value in the estate. In re Estate of Etheridge, 33 N.C. App. 585, 235 S.E.2d 924, cert. denied, 293 N.C. 253, 237 S.E.2d 535 (1977).

Wrongful Death Action. — In a wrongful death action, the real parties in interest were the beneficiaries as defined in the Wrongful Death Act, who were the same persons who would have received property had the decedent died intestate; where the decedent was not survived by a child, children, or any lineal descendant of a deceased child or children, or by a parent, the decedent's spouse received all of the wrongful death proceeds, and where the widow was not entitled to a wrongful death recovery, the remaining beneficiaries did not succeed to a full 100 percent, but only received their original percentage, so there were no beneficiaries to the wrongful death claim. Locust v. Pitt County Mem'l Hosp., 154 N.C. App. 103, 571 S.E.2d 668, 2002 N.C. App. LEXIS 1410 (2002), cert. denied, 356 N.C. 673, 579 S.E.2d 272 (2003).

Where decedent's ex-spouse abandoned her interest in the decedent's estate at the time of death, decedent's siblings were entitled to share in any wrongful death proceeds, distribution was dictated by the laws of intestacy, and decedent's sister, as administratrix had standing to file the action. Locust v. Pitt County Mem'l Hosp., Inc., 358 N.C. 113, 591 S.E.2d 543, 2004 N.C. LEXIS 20 (2004).

Wrongful Act Bars Husband from Share of Wrongful Death Recovery. — Where it is a husband's wrongful act which caused the death of his wife intestate, he may not share in a recovery from an action for wrongful death. Should the jury return a verdict in favor of the administrator of her estate, the court will enter judgment for only two thirds of the amount of the verdict. Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832, cert. denied, 279 N.C. 726, 184 S.E.2d 883 (1971).

In an action by an administrator under the Wrongful Death Act, G.S. 28A-18-2, where husband caused the death of his wife, the award must be reduced by the statutory share of the wrongdoer. St. Paul Fire & Marine Ins. Co. v. Lack, 476 F.2d 583 (4th Cir. 1973).

This result is not precluded by the "slayer statute," G.S. 31A-4, which excludes the wrongdoer from taking by declaring him to have constructively died prior to the deceased, since the slayer's exclusion by G.S. 31A-4 appears to apply only to inheritance from the decedent's "estate," while wrongful death awards have consistently been deemed not to pass through the personal estate of the deceased, but rather to arise out of a right of action belonging peculiarly to the personal representative for the benefit of the intestate successors. St. Paul Fire & Marine Ins. Co. v. Lack, 476 F.2d 583 (4th Cir. 1973).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

Remarriage Restores All Rights and Privileges. — When a married couple enters into a separation agreement, later divorces, and then remarries, each party to the marriage regains all rights and privileges incident to marriage unless there is evidence to the contrary. Batten v. Batten, 125 N.C. App. 685, 482 S.E.2d 18 (1997).

Intent to Release Share Implicit in Separation Agreement. — Where the intention of each party to the marriage to release his or her share in the estate of the other is implicit in the express provisions of their separation agreement, their situation and purpose at the time the instrument was executed, the law will imply release of rights under this section and specifically enforce the agreement. Lane v. Scarborough, 284 N.C. 407, 200 S.E.2d 622 (1973).

Provisions in a separation agreement that each would thereafter acquire, hold, and dispose of property as though unmarried and that each renounced the right to administer upon the estate of the other refuted the contention that one spouse intended to retain any rights in the other's estate. Lane v. Scarborough, 284 N.C. 407, 200 S.E.2d 622 (1973).

Wife May Be Administratrix Where Marital Relations Resumed. — Where, after the execution of a separation agreement and consent judgment between husband and wife, the wife returned to the marital home which she and her husband shared before the separation; thereafter the commissioners named in the consent judgment to sell the couple's joint property for division were instructed not to do so; the husband paid the wife's attorney for representing her in the litigation between them; and from the time the wife returned to the marital home until her husband's death, the husband and wife lived continuously in their marital residence, the wife was entitled to qualify as administratrix of the estate of her husband and share in his estate as his widow without prejudice by reason of the separation agreement and consent judgment. In re Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976).

Applied in Smith v. Perdue, 258 N.C. 686, 129 S.E.2d 293 (1963); Cox v. Shaw, 263 N.C. 361, 139 S.E.2d 676 (1965); Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979); Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

Cited in Ivery v. Ivery, 258 N.C. 721, 129 S.E.2d 457 (1963); Forgy v. Schwartz, 262 N.C. 185, 136 S.E.2d 668 (1964); Swain v. Tillet, 269 N.C. 46, 152 S.E.2d 297 (1967); In re Will of Farr, 277 N.C. 86, 175 S.E.2d 578 (1970); Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977); Newlin v. Gill, 32 N.C. App. 392, 232 S.E.2d 213 (1977); Harris v. Ashley, 38 N.C. App. 494, 248 S.E.2d 393 (1978); Bowling v. Combs, 60 N.C. App. 234, 298 S.E.2d 754 (1983); Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984); Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985); In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985); In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913 (1986); In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990); Olvera v. Edmundson, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 15284 (W.D.N.C. Sept. 21, 2001).

§ 29-15. Shares of others than surviving spouse.

Those persons surviving the intestate, other than the surviving spouse, shall take that share of the net estate not distributable to the surviving spouse, or the entire net estate if there is no surviving spouse, as follows:

(1) If the intestate is survived by only one child or by only one lineal descendant of only one deceased child, that person shall take the entire net estate or share, but if the intestate is survived by two or more lineal descendants of only one deceased child, they shall take as provided in G.S. 29-16; or

(2) If the intestate is survived by two or more children or by one child and any lineal descendant of one or more deceased children, or by lineal descendants of two or more deceased children, they shall take as provided in G.S. 29-16; or

(3) If the intestate is not survived by a child, children or any lineal descendant of a deceased child or children, but is survived by both parents, they shall take in equal shares, or if either parent is dead, the surviving parent shall take the entire share; or

(4) If the intestate is not survived by such children or lineal descendants or by a parent, the brothers and sisters of the intestate, and the lineal descendants of any deceased brothers or sisters, shall take as provided in G.S. 29-16; or

(5) If there is no one entitled to take under the preceding subdivisions of this section or under G.S. 29-14,

   a. The paternal grandparents shall take one half of the net estate in equal shares, or, if either is dead, the survivor shall take the entire one half of the net estate, and if neither paternal grandparent survives, then the paternal uncles and aunts of the intestate and the lineal descendants of deceased paternal uncles and aunts shall take said one half as provided in G.S. 29-16; and

b. The maternal grandparents shall take the other one half in equal shares, or if either is dead, the survivor shall take the entire one half of the net estate, and if neither maternal grandparent survives, then the maternal uncles and aunts of the intestate and the lineal descendants of deceased maternal uncles and aunts shall take one half as provided in G.S. 29-16; but

c. If there is no grandparent and no uncle or aunt, or lineal descendant of a deceased uncle or aunt, on the paternal side, then those of the maternal side who otherwise would be entitled to take one half as hereinbefore provided in this subdivision shall take the whole; or

d. If there is no grandparent and no uncle or aunt, or lineal descendant of a deceased uncle or aunt, on the maternal side, then those on the paternal side who otherwise would be entitled to take one half as hereinbefore provided in this subdivision shall take the whole. (1959, c. 879, s. 1.)

Legal Periodicals. — For note, "Does North Carolina Law Adequately Protect Surviving Spouses?" see 48 N.C.L. Rev. 361 (1970).

For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For note discussing the limitation on collateral inheritance in North Carolina, see 14 Wake Forest L. Rev. 1085 (1978).

CASE NOTES

Words Describing Relationships Bear Ordinary Meanings. — In carefully naming the persons who take in cases of intestacy using words describing family relationships such as "parents," "brothers," "sisters," "grandparents," "aunts" and "uncles," the legislature intended that these words bear their ordinary and usual meaning. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

And Cannot Be Expanded. — The words "brother," "parent" and "grandparent" cannot be expanded to include other relationships such as "great-grandfather" or "great uncle." Therefore, the maxim "Expressio unius est exclusio alterius" (the expression of one thing is the exclusion of another) tends to exclude collateral kin who are not in the parentela of the intestate's parents or grandparents. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Section 31A-2 Modifies Subdivision (3) of This Section. — Section 31A-2, which specifies acts barring rights of parents to intestate succession in child's estate and to administer child's estate, must be deemed a part of the Intestate Succession Act and a modification of subdivision (3) of this section, as fully as if it had been written thereinto or specifically designated as an amendment thereto. Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

When a gift is made to a class of "heirs," the intestacy laws govern not only the identification of the "heirs," but also the shares to which they are entitled. Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

Per Capita Distribution. — This chapter calls for a per capita distribution of the decedent's real and personal property to all surviving persons in the same degree of relationship to the decedent. The distribution scheme is commonly referred to as "per capita at each generation." Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

Wrongful Death Action. — In a wrongful death action, the real parties in interest were the beneficiaries as defined in the Wrongful Death Act, who were the same persons who would have received property had the decedent died intestate; where a widow, who was the decedent's sole intestate beneficiary, had abandoned the decedent before his death, she was not entitled to a wrongful death recovery, and since the remaining beneficiaries did not succeed to a full 100 percent, but only received their original percentage, there were no beneficiaries to the wrongful death claim. Locust v. Pitt County Mem'l Hosp., 154 N.C. App. 103, 571 S.E.2d 668, 2002 N.C. App. LEXIS 1410 (2002), cert. denied, 356 N.C. 673, 579 S.E.2d 272 (2003).

Where decedent's ex-spouse abandoned her interest in the decedent's estate at the time of death, decedent's siblings were entitled to share in any wrongful death proceeds, distribution was dictated by the laws of intestacy, and decedent's sister, as administratrix had standing to file the action. Locust v. Pitt County Mem'l Hosp., Inc., 358 N.C. 113, 591 S.E.2d 543, 2004 N.C. LEXIS 20 (2004).

Plaintiff father, having abandoned the deceased when the latter was a minor child, could not share in the proceeds of the settlement of the claim for wrongful death now in the hands of the administratrix. Williford v. Williford, 288 N.C. 506, 219 S.E.2d 220 (1975).

Applied in Smith v. Allied Exterminators, Inc., 279 N.C. 583, 184 S.E.2d 296 (1971); Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832 (1971); Bowen v. Constructors Equip. Rental Co., 283 N.C. 395, 196 S.E.2d 789 (1973); Forester v. Marler, 31 N.C. App. 84, 228 S.E.2d 646 (1976); Jernigan v. Stokley, 34 N.C. App. 358, 238 S.E.2d 318 (1977); McDowell v. Estate of Anderson, 69 N.C. App. 725, 318 S.E.2d 258 (1984); Betts v. Parrish, 312 N.C. 47, 320 S.E.2d 662 (1984).

Cited in Sloop v. Williams Exxon Serv., 24 N.C. App. 129, 210 S.E.2d 111 (1974); Newlin v. Gill, 32 N.C. App. 392, 232 S.E.2d 213 (1977); Christenbury v. Hedrick, 32 N.C. App. 708, 234 S.E.2d 3 (1977); Harris v. Ashley, 38 N.C. App. 494, 248 S.E.2d 393 (1978); In re Estate of McCoy, 39 N.C. App. 52, 249 S.E.2d 473 (1978); Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981); Herndon v. Robinson, 57 N.C. App. 318, 291 S.E.2d 305 (1982); Betts v. Parrish, 62 N.C. App. 77, 302 S.E.2d 288 (1983); Carver v. Carver, 310 N.C. 669, 314 S.E.2d 739 (1984); Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984); McKinney v. Mosteller, 321 N.C. 730, 365 S.E.2d 612 (1988); State v. Smith, 90 N.C. App. 161, 368 S.E.2d 33 (1988); Brimley v. Logging, 93 N.C. App. 467, 378 S.E.2d 52 (1989); Stutts v. Adair, 94 N.C. App. 227, 380 S.E.2d 411 (1989); State v. Gilmore, 330 N.C. 167, 409 S.E.2d 888 (1991); Hales v. Thompson, 111 N.C. App. 350, 432 S.E.2d 388 (1993); Early v. Bowen, 116 N.C. App. 206, 447 S.E.2d 167, 1994 N.C. App. LEXIS 906 (1994), cert. denied, 339 N.C. 611, 454 S.E.2d 249 (1995), cert. denied, 456 S.E.2d 519 (1995); Hixson v. Krebs, 136 N.C. App. 183, 523 S.E.2d 684, 1999 N.C. App. LEXIS 1311 (1999); In re Estate of Lunsford, 143 N.C. App. 646, 547 S.E.2d 483, 2001 N.C. App. LEXIS 326 (2001), cert. granted, 353 N.C. 727, 550 S.E.2d 779 (2001); Olvera v. Edmundson, — F. Supp. 2d —, 2001 U.S. Dist. LEXIS 15284 (W.D.N.C. Sept. 21, 2001); In re Estate of Lunsford, 359 N.C. 382, 610 S.E.2d 366, 2005 N.C. LEXIS 358 (2005); In re J.A.A., 175 N.C. App. 66, 623 S.E.2d 45, 2005 N.C. App. LEXIS 2706 (2005); In re C.C., 173 N.C. App. 375, 618 S.E.2d 813, 2005 N.C. App. LEXIS 2017 (2005).

ARTICLE 3.

Distribution among Classes.

§ 29-16. Distribution among classes.

(a) Children and Their Lineal Descendants. — If the intestate is survived by lineal descendants, their respective shares in the property which they are entitled to take under G.S. 29-15 of this Chapter shall be determined in the following manner:

(1) Children. — To determine the share of each surviving child, divide the property by the number of surviving children plus the number of deceased children who have left lineal descendants surviving the intestate.

(2) Grandchildren. — To determine the share of each surviving grandchild by a deceased child of the intestate in the property not taken under the preceding subdivision of this subsection, divide that property by the number of such surviving grandchildren plus the number of deceased grandchildren who have left lineal descendants surviving the intestate.

(3) Great-Grandchildren. — To determine the share of each surviving great-grandchild by a deceased grandchild of the intestate in the property not taken under the preceding subdivisions of this subsection, divide that property by the number of such surviving great-grandchildren plus the number of deceased great-grandchildren who have left lineal descendants surviving the intestate.

(4) Great-Great-Grandchildren. — To determine the share of each surviving great-great-grandchild by a deceased great-grandchild of the

intestate in the property not taken under the preceding subdivisions of this subsection, divide that property by the number of such surviving great-great-grandchildren plus the number of deceased great-great-grandchildren who have left lineal descendants surviving the intestate.

(5) Other Lineal Descendants of Children. — Divide, according to the formula established in the preceding subdivisions of this subsection, any property not taken under such preceding subdivisions, among the lineal descendants of the children of the intestate not already participating.

(b) Brothers and Sisters and Their Lineal Descendants. — If the intestate is survived by brothers and sisters or the lineal descendants of deceased brothers and sisters, their respective shares in the property which they are entitled to take under G.S. 29-15 of this Chapter shall be determined in the following manner:

(1) Brothers and Sisters. — To determine the share of each surviving brother and sister, divide the property by the number of surviving brothers and sisters plus the number of deceased brothers and sisters who have left lineal descendants surviving the intestate within the fifth degree of kinship to the intestate.

(2) Nephews and Nieces. — To determine the share of each surviving nephew or niece by a deceased brother or sister of the intestate in the property not taken under the preceding subdivision of this subsection, divide that property by the number of such surviving nephews or nieces plus the number of deceased nephews and nieces who have left lineal descendants surviving the intestate within the fifth degree of kinship to the intestate.

(3) Grandnephews and Grandnieces. — To determine the share of each surviving grandnephew or grandniece by a deceased nephew or niece of the intestate in the property not taken under the preceding subdivisions of this subsection, divide that property by the number of such surviving grandnephews and grandnieces plus the number of deceased grandnephews and grandnieces who have left children surviving the intestate.

(4) Great-Grandnephews and Great-Grandnieces. — To determine the share of each surviving child of a deceased grandnephew or grandniece of the intestate, divide equally among the great-grandnephews and great-grandnieces of the intestate any property not taken under the preceding subdivisions of this subsection.

(5) Grandparents and Others. — If there is no one within the fifth degree of kinship to the intestate entitled to take the property under the preceding subdivisions of this subsection, then the intestate's property shall go to those entitled to take under G.S. 29-15(5).

(c) Uncles and Aunts and Their Lineal Descendants. — If the intestate is survived by uncles and aunts or the lineal descendants of deceased uncles and aunts, their respective shares in the property which they are entitled to take under G.S. 29-15 shall be determined in the following manner:

(1) Uncles and Aunts. — To determine the share of each surviving uncle and aunt, divide the property by the number of surviving uncles and aunts plus the number of deceased uncles and aunts who have left children or grandchildren surviving the intestate.

(2) Children of Uncles and Aunts. — To determine the share of each surviving child of a deceased uncle or aunt of the intestate in the property not taken under the preceding subdivision of this subsection, divide that property by the number of surviving children of deceased uncles and aunts plus the number of deceased children of deceased uncles and aunts who have left children surviving the intestate.

(3) Grandchildren of Uncles and Aunts. — To determine the share of each surviving child of a deceased child of a deceased uncle or aunt of the intestate, divide equally among the grandchildren of uncles or aunts of the intestate any property not taken under the preceding subdivisions of this subsection. (1959, c. 879, s. 1; 1979, c. 107, ss. 2, 3.)

CASE NOTES

When a gift is made to a class of "heirs," the intestacy laws govern not only the identification of the "heirs," but also the shares to which they are entitled. Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

Per Capita Distribution. — This chapter calls for a per capita distribution of the decedent's real and personal property to all surviving persons in the same degree of relationship to the decedent. The distribution scheme is commonly referred to as "per capita at each generation." Rawls v. Rideout, 74 N.C. App. 368, 328 S.E.2d 783 (1985).

There is no logical reason for the Court of Appeals to favor a per capita distribution over a per stirpes distribution absent the intent of the testatrix as ascertained from the four corners of the will. Lewis v. Ecklin, 110 N.C. App. 73, 428 S.E.2d 855 (1993).

Not Function of Administrator to Partition Real Estate. — It is the duty of the administrator to make distribution of the surplus of his intestate's personal property among those entitled thereto, but it is not his function to partition the real estate of his decedent among the heirs. King v. Neese, 233 N.C. 132, 63 S.E.2d 123 (1951), decided under former § 28-149.

Siblings. — Where decedent's ex-spouse abandoned her interest in the decedent's estate at the time of death, decedent's siblings were entitled to share in any wrongful death proceeds, distribution was dictated by the laws of intestacy, and decedent's sister, as administratrix had standing to file the action. Locust v. Pitt County Mem'l Hosp., Inc., 358 N.C. 113, 591 S.E.2d 543, 2004 N.C. LEXIS 20 (2004).

Applied in Cummings v. Locklear, 12 N.C. App. 572, 183 S.E.2d 832 (1971); Jernigan v. Stokley, 34 N.C. App. 358, 238 S.E.2d 318 (1977); Ferguson v. Croom, 73 N.C. App. 316, 326 S.E.2d 373 (1985).

Cited in Sloop v. Williams Exxon Serv., 24 N.C. App. 129, 210 S.E.2d 111 (1974); House v. White, 35 N.C. App. 124, 240 S.E.2d 489 (1978); Harris v. Ashley, 38 N.C. App. 494, 248 S.E.2d 393 (1978); Ladd v. Estate of Kellenberger, 314 N.C. App. 477, 334 S.E.2d 751 (1985); Brimley v. Logging, 93 N.C. App. 467, 378 S.E.2d 52 (1989); Jamin v. Williamson, 94 N.C. App. 699, 381 S.E.2d 345 (1989); Early v. Bowen, 116 N.C. App. 206, 447 S.E.2d 167, 1994 N.C. App. LEXIS 906 (1994), cert. denied, 339 N.C. 611, 454 S.E.2d 249 (1995), cert. denied, 456 S.E.2d 519 (1995); Allen v. Piedmond Transp. Servs., Inc., 116 N.C. App. 234, 447 S.E.2d 835 (1994).

ARTICLE 4.

Adopted Children.

§ 29-17. Succession by, through and from adopted children.

(a) A child, adopted in accordance with Chapter 48 of the General Statutes or in accordance with the applicable law of any other jurisdiction, and the heirs of such child, are entitled by succession to any property by, through and from his adoptive parents and their heirs the same as if he were the natural legitimate child of the adoptive parents.

(b) An adopted child is not entitled by succession to any property, by, through, or from his natural parents or their heirs, except as provided in subsection (e) of this section.

(c) The adoptive parents and the heirs of the adoptive parents are entitled by succession to any property, by, through and from an adopted child the same as if the adopted child were the natural legitimate child of the adoptive parents.

(d) The natural parents and the heirs of the natural parents are not entitled by succession to any property, by, through or from an adopted child, except as provided in subsection (e) of this section.

(e) If a natural parent has previously married, is married to, or shall marry an adoptive parent, the adopted child is considered the child of such natural parent for all purposes of intestate succession. (1959, c. 879, s. 1.)

Legal Periodicals. — For article on interstate and foreign adoptions in North Carolina, see 40 N.C.L. Rev. 691 (1962).

For article, "Recognition of Foreign Judgments," see 50 N.C.L. Rev. 21 (1971).

For comment, "The Adoptee's Right of Access to Sealed Adoption Records in North Carolina," see 16 Wake Forest L. Rev. 563 (1980).

CASE NOTES

Editor's Note. *— Some of the cases below were decided under prior law.*

North Carolina recognizes the doctrine of equitable adoption. Lankford v. Wright, 347 N.C. 115, 489 S.E.2d 604 (1997).

Equitable adoption, does not confer the incidents of formal statutory adoption; rather, it merely confers rights of inheritance upon the foster child in the event of intestacy of the foster parents. Lankford v. Wright, 347 N.C. 115, 489 S.E.2d 604 (1997).

The term "lineal descendants" is defined at G.S. 29-2(4) as "all children of such person"; this would include even illegitimate children of a deceased female, under G.S. 29-19(a), and clearly includes adopted children, under this section. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

The purpose of subsection (e) of this section is to make it clear that the relationship of parent and child is not severed when the child is adopted by the spouse of the biological parent. In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

Rights of Adopted Child Same as for Natural Child. — The legislature has provided that an adopted child from the date of its adoption shall have the same property rights as a natural born child from the date of its birth. Headen v. Jackson, 255 N.C. 157, 120 S.E.2d 598 (1961), decided under former § 28-149, old § 29-1 and § 48-23.

Any provision of law which prevented an adopted child from sharing in property, by descent or distribution in the same manner and to the same extent as a natural born child, was swept away by the repealing clause in chapter 813, Session Laws of 1955. Headen v. Jackson, 255 N.C. 157, 120 S.E.2d 598 (1961).

An adopted child shall be entitled to inherit property by, through, and from his adoptive parents as if he were born the legitimate child of the adoptive parents. Greenlee v. Quinn, 255 N.C. 601, 122 S.E.2d 409 (1961).

Right of an adopted child to inherit vests as of death of her adoptive parent, and therefore where the parent died prior to the effective date of an act creating a new rule of descent and of distribution the act is not applicable. Wilson v. Anderson, 232 N.C. 521, 61 S.E.2d 447 (1950).

Inheritance from Brother of Adopting Parent. — Under the provisions of Session Laws 1955, c. 813, s. 6, an adopted child was entitled to inherit property from the brother of the adopting parent, notwithstanding that the decree of adoption was entered prior to the passage of the statute, the legislature having the power to determine who shall take the property of a person dying subsequent to the effective date of a legislative act. Bennett v. Cain, 248 N.C. 428, 103 S.E.2d 510 (1958).

Section Has No Bearing upon Whether Adopted Child Takes under Will. — The statutes relating to the right of adopted children to take as distributees and heirs have no bearing upon whether an adopted child takes under a will, except insofar as they establish and define the parent and child relationship between the adoptive parents and the adopted child. Bradford v. Johnson, 237 N.C. 572, 75 S.E.2d 632 (1953), decided under former § 28-149 and old § 29-1.

Biological Parent Need Not Join in Spouse's Petition for Adoption of Children. — Subsection (e) of this section and G.S. 48-7(d) were enacted, not to retain adopted children's status as "lineal descendants" by the former marriage, but instead to provide that the parent-child relationship between adopted children and their biological parent is not severed by the parent's spouse's adoption of her children from a former marriage. Since the relationship remains intact in this limited situation, it is not necessary for such a biological parent to become a co-petitioner in her husband's adoption of her legitimate children of a former marriage. This biological parent, however, must consent to the adoption, as must any biological parent who does not come within the ambit of G.S. 48-6. In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

Wife's failure to "join" in her husband's petition for the adoption of her two minor children by a previous marriage in no way affected her relationship with the children and was immaterial to a determination of her husband's distributive share under former G.S. 30-3(b). In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

Cited in Crumpton v. Mitchell, 303 N.C. 657, 281 S.E.2d 1 (1981); Jenkins v. Wheeler, 69 N.C. App. 140, 316 S.E.2d 354 (1984); Ladd v. Estate of Kellenberger, 314 N.C. App. 477, 334 S.E.2d 751 (1985).

Article 5.

Legitimated Children.

§ 29-18. Succession by, through and from legitimated children.

A child born an illegitimate who shall have been legitimated in accordance with G.S. 49-10 or 49-12 or in accordance with the applicable law of any other jurisdiction, and the heirs of such child, are entitled by succession to property by, through and from his father and mother and their heirs the same as if born in lawful wedlock; and if he dies intestate, his property shall descend and be distributed as if he had been born in lawful wedlock. (1959, c. 879, s. 1.)

Legal Periodicals. — For article, "Recognition of Foreign Judgments," see 50 N.C.L. Rev. 21 (1971).

CASE NOTES

Right to Inherit by, through and from Parents. — A legitimated child shall have the same right to inherit by, through, and from his father and mother as if such child had been born in lawful wedlock. Greenlee v. Quinn, 255 N.C. 601, 122 S.E.2d 409 (1961).

Right to Inherit from Collaterals. — The legislature intended to confer upon the legitimated child the same right to inherit from collateral relations as it would have had had it been born in lawful wedlock. Greenlee v. Quinn, 255 N.C. 601, 122 S.E.2d 409 (1961).

Cited in Hayes v. Dixon, 83 N.C. App. 52, 348 S.E.2d 609 (1986).

Article 6.

Illegitimate Children.

§ 29-19. Succession by, through and from illegitimate children.

(a) For purposes of intestate succession, an illegitimate child shall be treated as if he were the legitimate child of his mother, so that he and his lineal descendants are entitled to take by, through and from his mother and his other maternal kindred, both descendants and collaterals, and they are entitled to take from him.

(b) For purposes of intestate succession, an illegitimate child shall be entitled to take by, through and from:

(1) Any person who has been finally adjudged to be the father of such child pursuant to the provisions of G.S. 49-1 through 49-9 or the provisions of G.S. 49-14 through 49-16;

(2) Any person who has acknowledged himself during his own lifetime and the child's lifetime to be the father of such child in a written instrument executed or acknowledged before a certifying officer named in G.S. 52-10(b) and filed during his own lifetime and the

child's lifetime in the office of the clerk of superior court of the county where either he or the child resides.

Notwithstanding the above provisions, no person shall be entitled to take hereunder unless he has given written notice of the basis of his claim to the personal representative of the putative father within six months after the date of the first publication or posting of the general notice to creditors.

(c) Any person described under subdivision (b)(1) or (2) above and his lineal and collateral kin shall be entitled to inherit by, through and from the illegitimate child.

(d) Any person who acknowledges himself to be the father of an illegitimate child in his duly probated last will shall be deemed to have intended that such child be treated as expressly provided for in said will or, in the absence of any express provision, the same as a legitimate child. (1959, c. 879, s. 1; 1973, c. 1062, s. 1; 1975, c. 54, s. 1; 1977, c. 375, s. 6; c. 591; c. 757, s. 3.)

Legal Periodicals. — For note on illegitimacy in North Carolina, see 46 N.C.L. Rev. 813 (1968).

For note on constitutional law and illegitimate's paternal inheritance rights, see 16 Wake Forest L. Rev. 205 (1980).

For survey of 1982 law on property, see 61 N.C.L. Rev. 1171 (1983).

For 1984 survey, "Intestate Succession of Illegitimate Children in North Carolina," see 63 N.C.L. Rev. 1274 (1985).

For casenote: "The Established Standard for Fathers Who Have Acknowledged Paternity and Who Are Seeking Custody of Their Illegitimate Child(ren): Rosero v. Blake, 357 N.C. 193 (2003)," see 26 N.C. Cent. L.J. 116 (2003).

CASE NOTES

Statute Does Not Violate Equal Protection or Due Process Clauses. — This section and the statutes in pari materia are substantially related to the lawful State interests. They are intended to promote, and are not in violation of the equal protection and due process clauses. Mitchell v. Freuler, 297 N.C. 206, 254 S.E.2d 762 (1979); Herndon v. Robinson, 57 N.C. App. 318, 291 S.E.2d 305, appeal dismissed and cert. denied, 306 N.C. 557, 294 S.E.2d 223 (1982).

This section and G.S. 49-10 through 49-12 and 49-14 through 49-16, construed together, do not violate the equal protection clause of the United States Constitution. Mitchell v. Freuler, 297 N.C. 206, 254 S.E.2d 762 (1979).

The statutory scheme established by this section and the other statutes referred to herein (G.S. 49-14 through 49-16 and former G.S. 52-6(c)) does not discriminate against illegitimate children in such manner as to violate the Equal Protection Clause of U.S. Const., Amend. XIV. Outlaw v. Planters Nat'l Bank & Trust Co., 41 N.C. App. 571, 255 S.E.2d 189 (1979).

In General. — Illegitimate children may inherit from their putative fathers if they have been legitimated by one of the methods established in G.S. 49-10 through 49-14, or if paternity has been established in an action for criminal nonsupport. Helms v. Young-Woodard, 104 N.C. App. 746, 411 S.E.2d 184 (1991), cert. denied, 331 N.C. 117, 414 S.E.2d 756, 506 U.S. 829, 113 S. Ct. 91, 121 L. Ed. 2d 53 (1992).

Subdivision (b)(1) is constitutional on its face. Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

Application of subdivision (b)(1) to decedent's estate was not unconstitutional on grounds that decedent was not represented by counsel when he was adjudged the father of plaintiff's illegitimate children. Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

Different Treatment of Mother and Father Not Unconstitutional. — While this section classifies the illegitimate's mother and her heirs and the putative father and his heirs differently by placing the additional requirement on the father to establish his paternity by one of the statutorily prescribed methods before he is permitted to inherit, this classification is substantially related to permissible State interests. This section does not violate the equal protection clause of U.S. Const., Amend. XIV in this regard. Estate of Stern v. Stern, 66 N.C. App. 507, 311 S.E.2d 909 (1984), appeal dismissed, 471 U.S. 1011, 105 S. Ct. 2010, 85 L. Ed. 2d 294 (1985).

Interest of State in Inheritance Rights of Illegitimate Children. — By specifying the manner and time in which an illegitimate may establish his paternity, this State has sought (1) to mitigate the hardships created by former law (which permitted illegitimates to inherit only from the mother and from each other); (2) to equalize insofar as practical the inheritance rights of legitimate and illegitimate children; and, (3) at the same time to safeguard the just and orderly disposition of a decedent's property and the dependability of titles passing under intestate laws. Mitchell v. Freuler, 297 N.C. 206, 254 S.E.2d 762 (1979).

This section and the other statutes referred to herein (G.S. 49-14 through 49-16), insofar as they provide that an illegitimate child may inherit from its father only if paternity has been acknowledged in writing or finally adjudged in the lifetime of the father and otherwise in accord with those applicable statutes, establish a statutory scheme which bears an evident and substantial relation to the permissible and important interest of the State in providing for the just and orderly disposition of property at death. Outlaw v. Planters Nat'l Bank & Trust Co., 41 N.C. App. 571, 255 S.E.2d 189 (1979).

Interest of State in Inheritance by Father from Illegitimate Child. — The requirement imposed on the father of an illegitimate who would inherit from his illegitimate child is substantially related to the important State interests that this section is intended to promote. Estate of Stern v. Stern, 66 N.C. App. 507, 311 S.E.2d 909 (1984).

Birth certification amendment application form did not meet requirements of subsection (b) where it contained no statement by the putative father or anyone else that he was the father of the child, and even if his signature in the blank space involved could be construed to be an unambiguous acknowledgment of paternity, he did not swear to it before any official authorized to administer oaths. In re Will of Bunch, 86 N.C. App. 463, 358 S.E.2d 118 (1987).

The term "lineal descendants" is defined at G.S. 29-2(4) as "all children of such person"; this would include even illegitimate children of a deceased female, under subsection (a) of this section, and clearly includes adopted children, pursuant to G.S. 29-17. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Right to Inherit Established upon Adjudication of Paternity. — Once plaintiffs satisfied the notice requirement of this section, and showed that decedent had been adjudged their father under G.S. 49-1 through 49-9, their right to inherit was established as a matter of law; it did not depend upon a declaration in a court order or judgment. Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

A putative father and his kindred are only entitled to inherit from an illegitimate child if paternity has been established by one of the methods prescribed in G.S. 29-19(b). In re Estate of Morris, 123 N.C. App. 264, 472 S.E.2d 786 (1996).

Acknowledgment Not Filed. — Where petitioner acknowledged his paternity before a notary public and executed the "Affidavit Of Parentage For Child Born Out Of Wedlock" but never filed the acknowledgment with the clerk of court, he did not fulfill all the requirements under G.S. 29-19(b). In re Estate of Morris, 123 N.C. App. 264, 472 S.E.2d 786 (1996).

Compliance with Section Essential. — Where there has been no compliance with this section, illegitimate child has no right to inherit from deceased putative father. Hayes v. Dixon, 83 N.C. App. 52, 348 S.E.2d 609 (1986), cert. denied and appeal dismissed, 319 N.C. 224, 353 S.E.2d 402, cert. denied, 484 U.S. 824, 108 S. Ct. 88, 98 L. Ed. 2d 50 (1987).

Illegitimate child's complaint seeking a declaration that she was the sole heir of a decedent was properly dismissed where the complaint did not claim that the decedent was adjudged to be the child's father, or that the decedent had acknowledged himself to be the child's father in a written instrument which was duly executed and filed; absent G.S. 29-19(b), an illegitimate child had no right to inherit from his or her putative father, and, although a deoxyribonucleic acid (DNA) test had established that the decedent was the child's biological father, a positive DNA test was not listed in the the statute as a method of meeting the requirements to legitimate a child. Phillips v. Ledford, 162 N.C. App. 150, 590 S.E.2d 280, 2004 N.C. App. LEXIS 3 (2004), cert. denied, appeal dismissed, 358 N.C. 377, 597 S.E.2d 133 (2004).

Plea of Guilty in Bastardy Action as Basis for Inheritance by Child. — An illegitimate child may inherit, through intestate succession, from the estate of a father who acknowledged paternity to the child by pleading guilty in a criminal bastardy action. Sanders v. Brantley, 71 N.C. App. 797, 323 S.E.2d 426 (1984).

Notice under Subsection (b) as Condition Precedent. — The requirement of subsection (b) that illegitimate children give written notice of their claims of inheritance to the personal representatives of their putative fathers' estates within six months after the first publication or posting of general notice to creditors is a condition precedent to an illegitimate child's right to receive a distribution from the estate of a father who meets the description in subdivision (1) or (2) of subsection (b). Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

Form of Notice. — Subsection (b) does not specify any particular form the notice required of illegitimate children must take. Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

Plaintiffs' verified complaint seeking revocation of defendant's letters, which fully alleged the basis of their claim of entitlement to inherit from decedent and was received by defendant, as personal representative of the estate, within the statutory period for notice, satisfied the notice requirement of subsection (b) of this section. Estate of Lucas v. Jarrett, 55 N.C. App. 185, 284 S.E.2d 711 (1981).

The formalities of subdivision (b)(2) of this section serve a dual purpose. — As a method for establishing paternity, a written instrument acknowledging paternity, executed and filed with the clerk of superior court, assures the requisite degree of certainty. The formalities further assure that the decedent intended that the illegitimate child share in his estate, much in the same way that a father intentionally excludes legitimate children as beneficiaries under his will. Herndon v. Robinson, 57 N.C. App. 318, 291 S.E.2d 305, appeal dismissed and cert. denied, 306 N.C. 557, 294 S.E.2d 223 (1982).

Documents Inadequate under Subdivision (b)(2). — Plaintiff's proof of numerous written documents, signed by his putative father, which clearly acknowledged paternity, did not rise to the dignity of constructive compliance with subdivision (b)(2) of this section, where the documents were offered for purposes other than to establish paternity as contemplated under subdivision (b)(2). Herndon v. Robinson, 57 N.C. App. 318, 291 S.E.2d 305, appeal dismissed and cert. denied, 306 N.C. 557, 294 S.E.2d 223 (1982).

Action by Father Required to Include Illegitimate Child. — Just as a father must act to exclude a legitimate child from sharing in his estate, he must also act to include an illegitimate child. The distinction is an important one. Herndon v. Robinson, 57 N.C. App. 318, 291 S.E.2d 305, appeal dismissed and cert. denied, 306 N.C. 557, 294 S.E.2d 223 (1982).

Applicability of Subsection (d). — Subsection (d) of this section is clear in its meaning and applies only when the child is taking under a will from the putative father and not when the putative father or his heirs are attempting to inherit from the child under the intestacy statutes. Estate of Stern v. Stern, 66 N.C. App. 507, 311 S.E.2d 909 (1984).

No Inheritance from Father Prior to 1973 Amendment. — See Jolly v. Queen, 264 N.C. 711, 142 S.E.2d 592 (1965).

This section confers upon illegitimate children same rights enjoyed by legitimate children under laws of intestate succession once there is proper adjudication or acknowledgment of paternity. Notification of the personal representative within six months of published notice to creditors does not establish or define the illegitimate child's right, but merely sets a time limitation for an illegitimate child to seek its enforcement. Jefferys v. Tolin, 90 N.C. App. 233, 368 S.E.2d 201 (1988).

Subsection (b) is Statute of Limitation. — The six-month limitation period in subsection (b), relating to notice of the claim of an illegitimate child to take from father's estate, is a statute of limitation which is subject to being tolled under the provisions of G.S. 1-17. Jefferys v. Tolin, 90 N.C. App. 233, 368 S.E.2d 201 (1988).

Former Law. — See Flintham v. Holder, 16 N.C. 345 (1829); Fairly v. Priest, 56 N.C. 383 (1857); McBryde v. Patterson, 78 N.C. 412 (1878); Bettis v. Avery, 140 N.C. 184, 52 S.E. 584 (1905); Ashe v. Camp Mfg. Co., 154 N.C. 241, 70 S.E. 295 (1911); Brown v. Brown, 168 N.C. 4, 84 S.E. 25 (1915); Wilson v. Wilson, 189 N.C. 85, 126 S.E. 181 (1925); Bryant v. Bryant, 190 N.C. 372, 130 S.E. 21 (1925); Battle v. Shore, 197 N.C. 449, 149 S.E. 590 (1929); Paul v. Willoughby, 204 N.C. 595, 169 S.E. 226 (1933); Brown v. Holland, 221 N.C. 135, 19 S.E.2d 255 (1942); Board of Educ. v. Johnston, 224 N.C. 86, 29 S.E.2d 126 (1944).

Applied in Poteat v. Robinson, 90 N.C. App. 764, 370 S.E.2d 61 (1988).

Cited in Settle ex rel. Sullivan v. Beasley, 309 N.C. 616, 308 S.E.2d 288 (1983); Brimley v. Logging, 93 N.C. App. 467, 378 S.E.2d 52 (1989); Rosero v. Blake, 357 N.C. 193, 581 S.E.2d 41, 2003 N.C. LEXIS 605 (2003), cert. denied, 540 U.S. 1177, 124 S. Ct. 1407, 158 L. Ed. 2d 78 (2004).

§ 29-20. Descent and distribution upon intestacy of illegitimate children.

All the estate of a person dying illegitimate and intestate shall descend and be distributed, subject to the payment of costs of administration and other lawful claims against the estate, and subject to the payment of State inheritance or estate taxes, as provided in this Article. (1959, c. 879, s. 1; 1999-337, s. 6.)

Editor's Note. — Session Laws 1999-337, s. 46, provides: "This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by this act before the effective date of its amendment or repeal; nor does it affect the right to any refund or credit of a tax that accrued under the amended or repealed statute before the effective date of its amendment or repeal."

§ 29-21. Share of surviving spouse.

The share of the surviving spouse of an illegitimate intestate shall be the same as provided in G.S. 29-14 for the surviving spouse of a legitimate person. In determining whether the illegitimate intestate is survived by one or more parents as provided in G.S. 29-14(3), any person identified as the father under G.S. 29-19(b)(1) or (b)(2) shall be regarded as a parent. (1959, c. 879, s. 1; 1977, c. 757, s. 1.)

Editor's Note. — Section 29-14(3), referred to in this section, has been rewritten. For provisions as to illegitimate intestates who are survived by one or more parents, see now G.S. 29-14(a)(3) and 29-14(b)(3).

Legal Periodicals. — For article "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

CASE NOTES

Words Describing Relationships Bear Ordinary Meanings. — In carefully naming the persons who take in cases of intestacy using words describing family relationships such as "parents," "brothers," "sisters," "grandparents," "aunts" and "uncles," the legislature intended that these words bear their ordinary and usual meaning. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

And Cannot Be Expanded. — The words "brother," "parent" and "grandparent" cannot be expanded to include other relationships such as "great-grandfather" or "great uncle." Therefore, the maxim, "Expressio unius est exclusio alterius" (the expression of one thing is the exclusion of another) tends to exclude collateral kin who are not in the parentela of the intestate's parents or grandparents. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

Cited in Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

§ 29-22. Shares of others than the surviving spouse.

Those persons surviving the illegitimate intestate, other than the surviving spouse, shall take that share of the net estate provided in G.S. 29-15. In determining whether the illegitimate intestate is survived by one or more parents or their collateral kindred as provided in G.S. 29-15, any person identified as the father under G.S. 29-19(b)(1) or (b)(2) shall be regarded as a parent. (1959, c. 879, s. 1; 1977, c. 757, s. 2.)

CASE NOTES

Words Describing Relationships Bear Ordinary Meanings. — In carefully naming the persons who take in cases of intestacy using words describing family relationships such as "parents," "brothers," "sisters," "grandparents," "aunts" and "uncles," the legislature intended that these words bear their ordinary and usual meaning. Newlin v. Gill, 293 N.C. 348, 237 S.E.2d 819 (1977).

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ARTICLE 7.

Advancements.

§ 29-23. In general.

If a person dies intestate as to all his estate, property which he gave in his lifetime as an advancement shall be counted toward the advancee's intestate share, and to the extent that it does not exceed such intestate share, shall be taken into account in computing the estate to be distributed. (1959, c. 879, s. 1.)

Legal Periodicals. — For survey of 1980 property law, see 59 N.C.L. Rev. 1209 (1981).

CASE NOTES

A child must account for advancements in order to share by inheritance or by distribution in the real estate and personal property owned by the parent at death, and therefore it must be ascertained that the parent left property before the question of advancements can arise. Atkinson v. Bennett, 242 N.C. 456, 88 S.E.2d 76 (1955), decided under former Rule 2 of old § 29-1.

Decisions under Former Law as to Advancements. — See Stallings v. Stallings, 16 N.C. 298 (1829); Brown v. Brown, 37 N.C. 309 (1842); Lamb v. Carroll, 28 N.C. 4 (1845); Meadows v. Meadows, 33 N.C. 148 (1850); Headen v. Headen, 42 N.C. 159 (1850); Daves v. Haywood, 54 N.C. 253 (1854); Skinner v. Wynne, 55 N.C. 41 (1854); Shiver v. Brock, 55 N.C. 137 (1855); Ward v. Riddick, 57 N.C. 22 (1858); Jerkins v. Mitchell, 57 N.C. 207 (1858); Dixon v. Coward, 57 N.C. 354 (1859); Hollister v. Attmore, 58 N.C. 373 (1860); Bradsher v. Cannady, 76 N.C. 445 (1877); Melvin v. Bullard, 82 N.C. 34 (1880); Harper v. Harper, 92 N.C. 300 (1885); Eller v. Lillard, 107 N.C. 486, 12 S.E. 462 (1890); Kiger v. Terry, 119 N.C. 456, 26 S.E. 38 (1896); Ex parte Griffin, 142 N.C. 116, 54 S.E. 1007 (1906); Thompson v. Smith, 160 N.C. 256, 75 S.E. 1010 (1912); Nobles v. Davenport, 183 N.C. 207, 111 S.E. 180 (1922); Southern Distrib. Co. v. Carraway, 189 N.C. 420, 127 S.E. 427 (1925); Paschal v. Paschal, 197 N.C. 40, 147 S.E. 680 (1929); Prevette v. Prevette, 203 N.C. 89, 164 S.E. 623 (1932); Wolfe v. Galloway, 211 N.C. 361, 190 S.E. 213 (1937); Parker v. Eason, 213 N.C. 115, 195 S.E. 360 (1938); Harrelson v. Gooden, 229 N.C. 654, 50 S.E.2d 901 (1948).

Applied in Thompson v. Soles, 299 N.C. 484, 263 S.E.2d 599 (1980).

§ 29-24. Presumption of gift.

A gratuitous inter vivos transfer is presumed to be an absolute gift and not an advancement unless shown to be an advancement. (1959, c. 879, s. 1.)

CASE NOTES

Right to Change Advancement into Gift. — While a parent cannot change into an advancement that which was intended as a gift at the time of delivery, there is no apparent reason why a parent cannot by deed change into a gift that which was at the time of delivery intended as an advancement. Atkinson v. Bennett, 242 N.C. 456, 88 S.E.2d 76 (1955), decided under former Rule 2 of old § 29-1.

Effect of Previous Advancement on Conveyance by Deed. — Where more than a year after an alleged advancement, the parent executes a deed conveying all of her property in equal division between two of the children, without providing for advancements previously made, the asserted advancement to one of them should not be taken into account in the division of the property conveyed by the deed. Atkinson v. Bennett, 242 N.C. 456, 88 S.E.2d 76 (1955), decided under former Rule 2 of old § 29-1.

Applied in Lassiter v. Lassiter, 15 N.C. App. 588, 190 S.E.2d 283 (1972).

§ 29-25. Effect of advancement.

If the amount of the advancement equals or exceeds the intestate share of the advance, he shall be excluded from any further portion in the distribution of the estate, but he shall not be required to refund any part of such advancement; and if the amount of the advancement is less than his share, he shall be entitled to such additional amount as will give him his full share of the intestate donor's estate. (1959, c. 879, s. 1.)

CASE NOTES

Purpose. — The proviso to former Rule 2 of old G.S. 29-1 was enacted to establish a perfect equality in the division of the intestate's whole estate, real and personal, amongst an intestate's children, excepting only, that no property given by a parent to a child is in any case to be taken away. King v. Neese, 233 N.C. 132, 63 S.E.2d 123 (1951). See Atkinson v. Bennett, 242 N.C. 456, 88 S.E.2d 76 (1955).

§ 29-26. Valuation.

The value of the property given as an advancement shall be determined as of the time when the advancee came into possession or enjoyment, or at the time of the death of the intestate, whichever first occurs. However, if the value of the property, so advanced, is stated by the intestate donor in a writing signed by him and designating the gift as an advancement, such value shall be deemed the value of the advancement. (1959, c. 879, s. 1.)

§ 29-27. Death of advancee before intestate donor.

If the advancee dies before the intestate donor leaving a lineal heir or heirs who take by intestate succession from the intestate donor, the advancement shall be taken into account in the same manner as if it had been made directly to such heir or heirs, but the value shall be determined as of the time the original advancee came into possession or enjoyment, or when the heir or heirs came into possession or enjoyment or at the time of the death of the intestate donor, whichever first occurs. (1959, c. 879, s. 1; 1961, c. 958, s. 3.)

§ 29-28. Inventory.

If any person who has, in the lifetime of an intestate donor, received a part of the donor's property, refuses, upon order of the clerk of superior court of the county in which the administrator or collector qualifies, to give an inventory on oath, setting forth therein to the best of his knowledge and belief the particulars of the transfer of such property, he shall be considered to have received his full share of the donor's estate, and shall not be entitled to receive any further part or share. (1959, c. 879, s. 1.)

§ 29-29. Release by advancee.

If the advancee acknowledges to the intestate donor by a signed writing that he has been advanced his full share of the intestate donor's estate, both he and those claiming through him shall be excluded from any further participation in the intestate donor's estate. (1959, c. 879, s. 1.)

ARTICLE 8.

Election to Take Life Interest in Lieu of Intestate Share.

§ 29-30. Election of surviving spouse to take life interest in lieu of intestate share provided.

(a) In lieu of the intestate share provided in G.S. 29-14 or G.S. 29-21, or of the elective share provided in G.S. 30-3.1, the surviving spouse of an intestate or the surviving spouse who has petitioned for an elective share shall be entitled to take as his or her intestate share or elective share a life estate in one third in value of all the real estate of which the deceased spouse was seised and possessed of an estate of inheritance at any time during coverture, except that real estate as to which the surviving spouse:

(1) Has waived his or her rights by joining with the other spouse in a conveyance thereof, or

(2) Has release or quitclaimed his or her interest therein in accordance with G.S. 52-10, or

(3) Was not required by law to join in conveyance thereof in order to bar the elective life estate, or

(4) Is otherwise not legally entitled to the election provided in this section.

(b) Regardless of the value thereof and despite the fact that a life estate therein might exceed the fractional limitation provided for in subsection (a), the life estate provided for in subsection (a) shall at the election of the surviving spouse include a life estate in the usual dwelling house occupied by the surviving spouse at the time of the death of the deceased spouse if such dwelling house were owned by the deceased spouse at the time of his or her death, together with the outbuildings, improvements and easements thereunto belonging or appertaining, and lands upon which situated and reasonably necessary to the use and enjoyment thereof, as well as a fee simple ownership in the household furnishings therein.

(c) The election provided for in subsection (a) shall be made by the filing of a notice thereof with the clerk of the superior court of the county in which the administration of the estate is pending, or, if no administration is pending, then with the clerk of the superior court of any county in which the administration of the estate could be commenced. Such election shall be made:

(1) At any time within one month after the expiration of the time fixed for the filing of the petition for elective share under Article 1A of Chapter 30, or

(2) In case of intestacy, then within 12 months after the death of the deceased spouse if letters of administration are not issued within that period, or

(3) If letters of administration are issued within 12 months after the date of the death of the deceased spouse, then within one month after the expiration of the time limited for filing claims against the estate, or

(4) If litigation that affects the share of the surviving spouse in the estate is pending, then within such reasonable time as may be allowed by written order of the clerk of the superior court.

(c1) The notice of election shall:

(1) Be directed to the clerk with whom filed;

(2) State that the surviving spouse making the same elects to take under this section rather than under the provisions of G.S. 29-14, 29-21, or 30-3.1, as applicable;

(3) Set forth the names of all heirs, devisees, legatees, personal representatives and all other persons in possession of or claiming an estate or an interest in the property described in subsection (a); and

(4) Request the allotment of the life estate provided for in subsection (a).

(c2) The notice of election may be in person, or by attorney authorized in a writing executed and duly acknowledged by the surviving spouse and attested by at least one witness. If the surviving spouse is a minor or an incompetent, the notice of election may be executed and filed by a general guardian or by the guardian of the person or estate of the minor or incompetent spouse. If the minor or incompetent spouse has no guardian, the notice of election may be executed and filed by a next friend appointed by the clerk. The notice of election, whether in person or by attorney, shall be filed as a record of the court, and a summons together with a copy of the notice shall be served upon each of the interested persons named in the notice of election.

(d) In case of election to take a life estate in lieu of an intestate share or elective share, as provided in either G.S. 29-14, 29-21, or 30-3.3(a), the clerk of superior court, with whom the notice of election has been filed, shall summon and appoint a jury of three disinterested persons who being first duly sworn shall promptly allot and set apart to the surviving spouse the life estate provided for in subsection (a) and make a final report of such action to the clerk.

(e) The final report shall be filed by the jury not more than 60 days after the summoning and appointment thereof, shall be signed by all jurors, and shall describe by metes and bounds the real estate in which the surviving spouse shall have been allotted and set aside a life estate. It shall be filed as a record of court and a certified copy thereof shall be filed and recorded in the office of the register of deeds of each county in which any part of the real property of the deceased spouse, affected by the allotment, is located.

(f) In the election and procedure to have the life estate allotted and set apart provided for in this section, the rules of procedure relating to partition proceedings shall apply except insofar as the same would be inconsistent with the provisions of this section.

(g) Neither the household furnishings in the dwelling house nor the life estates taken by election under this section shall be subject to the payment of debts due from the estate of the deceased spouse, except those debts secured by such property as follows:

(1) By a mortgage or deed of trust in which the surviving spouse has waived his or her rights by joining with the other spouse in the making thereof; or

(2) By a purchase money mortgage or deed of trust, or by a conditional sales contract of personal property in which title is retained by the vendor, made prior to or during the marriage; or

(3) By a mortgage or deed of trust made prior to the marriage; or

(4) By a mortgage or deed of trust constituting a lien on the property at the time of its acquisition by the deceased spouse either before or during the marriage.

(h) If no election is made in the manner and within the time provided for in subsection (c) the surviving spouse shall be conclusively deemed to have waived his or her right to elect to take under the provisions of this section, and any interest which the surviving spouse may have had in the real estate of the deceased spouse by virtue of this section shall terminate. (1959, c. 879, s. 1; 1961, c. 958, ss. 4-8; 1965, c. 848; 1997-456, s. 27; 2000-178, s. 3.)

Cross References. — For provision that a decedent's one-half of community property is not subject to the right to elect a life estate under this Article, see G.S. 31C-3. As to right of elective share, see G.S. 30-3.1 et seq.

Editor's Note. — The subsection designations (c1) and (c2) were added pursuant to S.L. 1997-456, s. 27, which authorized the Revisor of Statutes to renumber or reletter sections and parts of sections having a number or letter designation that is incompatible with the General Assembly's computer database.

Legal Periodicals. — For article "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For article on installment land contracts in North Carolina, see 3 Campbell L. Rev. 29 (1981).

For comment, "Offer to Purchase and Contract: Buyer Beware," see 8 Campbell L. Rev. 473 (1986).

For comment, "The Uniform Probate Code's 'Augmented Estate' Concept: A Remedy for the North Carolina Dissent Statute," see 12 Campbell L. Rev. 425 (1990).

For article, "Legislative Kudzu and the New Millennium: An Opportunity for Reflection and Reform," see 23 Campbell L. Rev. 157 (2001).

CASE NOTES

I. General Consideration.
II. Pending Litigation.

I. GENERAL CONSIDERATION.

Section Preserves Benefits of Dower and Curtesy. — Dower, as such, has been abolished in North Carolina, but this section preserves to a surviving spouse the benefits of the former rights of dower and curtesy. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965); Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969); Taylor v. Bailey, 49 N.C. App. 216, 271 S.E.2d 296 (1980), appeal dismissed, 301 N.C. 726, 274 S.E.2d 235 (1981).

This section has the practical effect of providing the benefits of dower to the surviving spouse, at her election. Peoples Oil Co. v. Richardson, 271 N.C. 696, 157 S.E.2d 369 (1967).

To protect the rights of dower or curtesy, the General Assembly has prescribed regulations and limitations on the right of a married person to convey his or her real property free from the elective life estate provided for his or her spouse by this section. Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

This section limits the right of a married person to convey his or her real property free from the elective life estate provided by this section. Taylor v. Bailey, 49 N.C. App. 216, 271 S.E.2d 296 (1980), appeal dismissed, 301 N.C. 726, 274 S.E.2d 235 (1981).

Purpose. — The reason for granting the surviving spouse an election or choice is to prevent such spouse from being rendered penniless and turned out of doors by reason of a small net estate or an insolvent estate. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

A surviving spouse is given this election so as not to be rendered penniless and would elect this option when the estate is small or insolvent. Taylor v. Bailey, 49 N.C. App. 216, 271 S.E.2d 296 (1980), appeal dismissed, 301 N.C. 726, 274 S.E.2d 235 (1981).

Trial court erred in admitting the testimony of the brother's wife about conversations she had with decedent, and about conversations she overheard between decedent and the brother; since the wife was an interested party because she stood to inherit the property the brother was seeking if his specific performance action to enforce decedent's contract to make a will in the brother's favor was resolved in the brother's favor, she was barred from testifying about what a dead man had said in that regard. Taylor v. Abernethy, 174 N.C. App. 93, 620 S.E.2d 242, 2005 N.C. App. LEXIS 2281 (2005), appeal dismissed, — N.C. —, 630 S.E.2d 454 (2006), cert. denied, — N.C. —, 630 S.E.2d 454 (2006).

Present Right of Possession Not Conferred. — A wife is not a real party in interest so as to interpose as a defense or counterclaim in an action in ejectment instituted by her husband's grantee that her husband had fraudulently conveyed the lands without her joinder in order to deprive her of the possession thereof, since G.S. 29-14, defining the share of the surviving spouse of an intestate, and this section, providing for a life estate at the election of the surviving spouse, do not give her a present right of possession. Peoples Oil Co. v. Richardson, 271 N.C. 696, 157 S.E.2d 369 (1967).

Effect of Inchoate Dower Interest. — An inchoate dower interest is not an estate in land nor a vested interest, but, nevertheless, it acts as an encumbrance upon real property. Taylor v. Bailey, 49 N.C. App. 216, 271 S.E.2d 296 (1980), appeal dismissed, 301 N.C. 726, 274 S.E.2d 235 (1981).

Different Time Limits Are Fixed to Give Surviving Spouse Opportunity to Decide. — The reason different time limits are fixed for making the election, under the different circumstances, as set out in subsection (c), subdivisions (1), (2), (3) and (4), is to give the surviving spouse ample opportunity to make a decision as to which choice is most beneficial. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Not Subject to Ordinary Debts of Estate. — The life estate, which the surviving spouse elects, is not subject to the payment of the ordinary debts due from the estate of the deceased spouse. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Thus, Spouse Would Elect Life Estate Where Estate Is Insolvent. — A surviving spouse would certainly elect to take a life estate where it would require a sale of all of the property of deceased's estate to pay the debts. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Inchoate Right to Dower May Be Protected by Redemption from Tax Sale. — A wife who claims in property an inchoate right to dower is possessed of such an interest that she clearly has the right to protect such interest by redeeming such property from a tax sale. Samet v. United States, 242 F. Supp. 214 (M.D.N.C. 1965).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

Where seller's wife refused to release her dower interest in the subject property, buyer is entitled to specific performance on the contract to convey the property, with an abatement in the purchase price for the value of defendant's wife's dower interest and for rents and profits for the period he was denied possession. Taylor v. Bailey, 49 N.C. App. 216, 271 S.E.2d 296 (1980), appeal dismissed, 301 N.C. 726, 274 S.E.2d 235 (1981).

Separately Conveyed Property Subject to Life Estate. — Where a married person conveys separate property without permission or joinder of their spouse and the non-owner spouse survives the owner spouse, the conveyed property is subject to the non-owner spouse's elective life estate. Melvin v. Mills-Melvin, 126 N.C. App. 543, 486 S.E.2d 84 (1997).

Applied in Lucas v. Felder, 261 N.C. 169, 134 S.E.2d 154 (1964).

Cited in Smith v. Smith, 265 N.C. 34, 143 S.E.2d 311 (1965); McLeod v. McLeod, 266 N.C. 144, 146 S.E.2d 65 (1966).

II. PENDING LITIGATION.

Subdivision (c)(4) Authorizes Fixing of Time for Election Where Litigation Is Pending. — Subdivision (c)(4) contemplates that the outcome of the litigation may well determine whether the surviving spouse will elect to take a life estate. Therefore, it authorizes the surviving spouse, if such litigation is pending, to request of the clerk a written order allowing a reasonable time within which the notice of election and the proceedings pursuant thereto may be filed and instituted. Upon such request, it becomes the duty of the clerk forthwith to make a written order fixing a time within which an election may be filed in accordance with subsection (c). Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

"Share" under Subdivision (c)(4) Means Any Share Spouse Is Entitled to. — As used in subdivision (c)(4), "share" means such share in the estate (not necessarily the net estate or property) as the surviving spouse shall be entitled to take by any provision of this Chapter. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Any Litigation Affecting Spouse's Choice Affects Such Share. — Any litigation which may substantially and materially affect the choice the surviving spouse is entitled to make "affects the share of the surviving spouse in the estate" under subdivision (c)(4). Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Such as Suit on Disputed Claim Large Enough to Render Estate Insolvent. — If there is a disputed claim which, if allowed, would render the estate insolvent or nearly so, and which, if disallowed, would leave a large net estate, the outcome of the suit on the claim would affect the share of the surviving spouse and might well determine the matter of election, though the subject of the litigation is a mere debt and not the title to land. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Or Suit to Set Aside Deed from Son to Surviving Spouse of His Interest in Estate. — Where, before the time limit for making an election, as provided in subdivision (c)(3), had expired, a son instituted litigation to set aside a deed to his mother of his interest in his deceased father's lands, on the ground that she had defrauded him, the outcome of the litigation would affect her choice or election, i.e., her share of the estate. The pendency of the litigation extended her time for making the election. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Action by Widow Not "Pending" Litigation. — An action by the widow, commenced after time for election had expired, to declare void a deed executed by her husband which conveyed the husband's separate realty to his children of a prior marriage, does not constitute "pending" litigation within the meaning of subdivision (c)(4) of this section. Heller v. Heller, 7 N.C. App. 120, 171 S.E.2d 335 (1969).

Time Allowed Should Be Reasonable Time after Litigation Ends. — The time allowed under subdivision (c)(4) should be such time after the termination of the pending litigation as to the clerk, in the exercise of his sound discretion, seems reasonable under the circumstances. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

And 20 Days Is Not Unreasonable. — Twenty days allowed under subdivision (c)(4) by the clerk for filing notice of election and issuing of summons is not unreasonable. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

The order fixing the time limit under subdivision (c)(4) must be made forthwith upon the ex parte request of the surviving spouse. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Such Order Is Only Ministerial. — The written order under subdivision (c)(4) is only ministerial, it merely fixes the time limit, and it is not an adjudication of any issues or questions of law which may be raised in the proceeding between the surviving spouse and other interested parties. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Rights of Parties Are Not Determined Until Later. — The rights of the parties are determined after notice of election has been filed pursuant to the order fixing the time limit, summons served and the pleadings are in. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Procedure Is in Accordance with Rules Relating to Partition. — Proceedings determining the rights of the parties and allotting the life estate are in accordance with the rules of procedure relating to partition of lands as far as practicable. Smith v. Smith, 265 N.C. 18, 143 S.E.2d 300 (1965).

Chapter 30.

Surviving Spouses.

Article 1.

Dissent from Will.

Sec.
30-1 through 30-3. [Repealed].

Article 1A.

Elective Share.

30-3.1. Right of elective share.
30-3.2. Definitions.
30-3.3. Property passing to surviving spouse.
30-3.4. Procedure for determining the elective share.
30-3.5. Recovery of assets by personal representative.
30-3.6. Waiver of rights.

Article 2.

Dower.

30-4 through 30-10. [Repealed.]

Article 3.

Allotment of Dower.

30-11 through 30-14. [Repealed.]

Article 4.

Year's Allowance.

Part 1. Nature of Allowance.

30-15. When spouse entitled to allowance.
30-16. Duty of personal representative, magistrate, or clerk to assign allowance.

Sec.
30-17. When children entitled to an allowance.
30-18. From what property allowance assigned.

Part 2. Assigned by Magistrate or Clerk.

30-19. Value of property ascertained.
30-20. Procedure for assignment.
30-21. Report of clerk or magistrate.
30-22. [Repealed.]
30-23. Right of appeal.
30-24. Hearing on appeal.
30-25. Personal representative entitled to credit.
30-26. When above allowance is in full.

Part 3. Assigned in Superior Court.

30-27. Surviving spouse or child may apply to superior court.
30-28. Nature of proceeding; parties.
30-29. What complaint must show.
30-30. Judgment and order for commissioners.
30-31. Duty of commissioners; amount of allowance.
30-32. Exceptions to the report.
30-33. Confirmation of report; execution.

Article 1.

Dissent from Will.

§§ 30-1 through 30-3: Repealed by Session Laws 2000-178, s. 1, effective January 1, 2001, and applicable to estates of decedents dying on or after that date.

Cross References. — As to right of elective share, see G.S. 30-3.1 et seq.

Article 1A.

Elective Share.

§ 30-3.1. Right of elective share.

(a) Elective Share. — The surviving spouse of a decedent who dies domiciled in this State has a right to claim an "elective share", which means an amount equal to (i) the applicable share of the Total Net Assets, as defined in G.S.

30-3.2(4), less (ii) the value of Property Passing to Surviving Spouse, as defined in G.S. 30-3.3(a). The applicable share of the Total Net Assets is as follows:

(1) If the decedent is not survived by any lineal descendants, one-half of the Total Net Assets.

(2) If the decedent is survived by one child, or lineal descendants of one deceased child, one-half of the Total Net Assets.

(3) If the decedent is survived by two or more children, or by one or more children and the lineal descendants of one or more deceased children, or by the lineal descendants of two or more deceased children, one-third of the Total Net Assets.

(b) Reduction of Applicable Share. — In those cases in which the surviving spouse is a second or successive spouse, and the decedent has one or more lineal descendants surviving by a prior marriage but there are no lineal descendants surviving by the surviving spouse, the applicable share as determined in subsection (a) of this section shall be reduced by one-half.

(c) Death Taxes. — Death taxes shall be taken into account as a claim against the estate in determining Total Net Assets only to the extent that the assets received by the surviving spouse do not qualify for the federal estate tax marital deduction pursuant to section 2056 of the Code or similar provisions under the laws of any other applicable taxing jurisdiction. The amount of such claims shall equal the difference between the amount of such death taxes as finally determined and the amount such death taxes would have been if all assets received by the surviving spouse had qualified for the federal estate tax marital deduction pursuant to section 2056 of the Code and similar provisions under the laws of any other applicable taxing jurisdictions. (2000-178, s. 2; 2003-296, s. 1.)

Cross References. — As to intestate succession, see G.S. 29-1 et seq. As to abolition of dower and curtesy, see G.S. 29-4. For provision that a decedent's half of community property is not subject to the surviving spouse's right to petition for an elective share, see G.S. 31C-3.

Editor's Note. — Session Laws 2000-178, ss. 1 and 2, effective January 1, 2001, and applicable to estates of decedents dying on or after that date, repeal G.S. 30-1 to 30-3, relating to the surviving spouse's right to dissent from his or her deceased spouse's will, and enact this article, relating to the right to claim an elective share. Case notes from repealed G.S. 30-1 to 30-3 have been placed under G.S. 30-3.1 to 30-3.6, as appropriate.

Subsections (a) and (c), as amended by Session Laws 2003-296, s. 1, effective January 1, 2004, are applicable to estates of decedents dying on or after that date.

Legal Periodicals. — For discussion of prior law, see 11 N.C.L. Rev. 274 (1933); 23 N.C.L. Rev. 380 (1945).

For note on dissent by incompetent widow through her guardian, see 35 N.C.L. Rev. 520 (1957).

For note on constitutionality of husband's right to dissent from wife's will, under former law, see 41 N.C.L. Rev. 311 (1963).

For case law survey on devolution of property, see 41 N.C.L. Rev. 432 (1963).

For note, "Contracts to Devise — Effect of Excluded Forced Heirs," see 47 N.C.L. Rev. 905 (1969).

For note, "Does North Carolina Law Adequately Protect Surviving Spouses?" see 48 N.C.L. Rev. 361 (1970).

For article, "Transferring North Carolina Real Estate Part I: How the Present System Functions," see 49 N.C.L. Rev. 413 (1971).

For note on a surviving spouse's right to dissent, under prior law, see 16 Wake Forest L. Rev. 251 (1980).

For note on the right of surviving spouse to dissent, under prior law, from deceased spouse's will when survivor receives less than an intestate share of deceased's net estate, see 12 N.C. Cent. L.J. 511 (1981).

For comment, "The North Carolina Dissent Statutes: The Seeds of Inequities Germinate ...," see 8 Campbell L. Rev. 449 (1986).

For comment, "The Uniform Probate Code's 'Augmented Estate' Concept: A Remedy for the North Carolina Dissent Statute," see 12 Campbell L. Rev. 425 (1990).

For article, "A Spouse's Right to Control Assets During Marriage: Is North Carolina Living in the Middle Ages?", see 18 Campbell L. Rev. 203 (1996).

North Carolina's New Elective Share Statute: Much Ado About Nothing?, 36 Wake Forest L. Rev. 795 (2001).

CASE NOTES

I. Decisions under Current Law.
II. Decisions under Prior Law.
  A. In General.
  B. Lineal Descendants.
  C. Second or Successive Spouse.
  D. Federal Estate Tax.

I. DECISIONS UNDER CURRENT LAW.

Reconciliation After Separation Agreement. — During a separation, the surviving spouse and the decedent prepared a separation agreement containing a provision wherein they waived the right to inheritance rights from each others' estates, but the couple thereafter reconciled and lived together until the decedent's death; thus, the surviving spouse had a right to claim an elective share under G.S. 30-3.1 because the waiver of inheritance rights was rescinded and canceled under G.S. 52-10.2 by the reconciliation of the decedent and the surviving spouse. In re Estate of Archibald, — N.C. App. —, 644 S.E.2d 264, 2007 N.C. App. LEXIS 1046 (2007).

II. DECISIONS UNDER PRIOR LAW.

A. In General.

Editor's Note. — *The cases below were decided under former G.S. 30-1 to 30-3 and corresponding prior provisions, relating to the right to dissent.*

Constitutionality of Former Provisions. — The provisions of, former G.S. 30-1, 30-2, and 30-3, insofar as they gave a husband a right in certain cases to dissent from his deceased wife's will, and to take a specified share of his deceased wife's real and personal property, violated the former provisions of N.C. Const., Art. X, G.S. 6 (see now N.C. Const., Art. X, G.S. 4), since they diminished a married woman's estate disposed of by her will, and restricted and abridged her constitutional power to dispose of her property by will as if she were unmarried. Dudley v. Staton, 257 N.C. 572, 126 S.E.2d 590 (1962), commented on in 41 N.C.L. Rev. 311 (1963).

Former G.S. 30-1, 30-2, and 30-3, insofar as they gave a husband the right in certain instances to dissent from his deceased wife's will and take a specified share of her estate, were unconstitutional under former N.C. Const., Art. X, G.S. 6 (see now N.C. Const., Art. X, G.S. 4), to the extent that they diminished pro tanto a devise of her separate estate in accordance with a will executed by her. But the adoption by the voters of the amendment to former N.C. Const., Art. X, G.S. 6 (see now N.C. Const., Art. X, G.S. 4), restored, subject to the qualifications set forth in Session Laws 1963, c. 1209, the right of the husband to dissent from the will of his wife. Fullam v. Brock, 271 N.C. 145, 155 S.E.2d 737 (1967); Fullam v. Brock, 271 N.C. 145, 155 S.E.2d 737 (1967).

Former G.S. 30-3(b), which provided that a second or successive spouse who dissented from the will of his deceased spouse should take only one half the amount provided by the Intestate Succession Act, G.S. 29-1 et seq., for the surviving spouse if the testator had surviving him lineal descendants by a former marriage but there were no surviving lineal descendants by the second or successive marriage, was not arbitrarily discriminatory and capricious so as to be violative of the due process provisions of the federal and State Constitutions. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

The provisions of § 1-254 did not confer subject matter jurisdiction on the court to hear the plaintiffs' challenge to the defendant's right to dissent; because former G.S. 30-1(c) and G.S. 1-254 govern mutually exclusive subject matter, each must be construed separately; although both an action contesting a surviving spouse's right of dissent and an action construing a will in part involve estate valuations (the dissent action involving valuation of the entire estate and the declaratory judgment action involving valuation of the testamentary estate), the actions are still fundamentally different in nature. Ripley v. Day , 139 N.C. App. 630, 534 S.E.2d 620, 2000 N.C. App. LEXIS 992 (2000).

Former § 30-1(c) and § 1-254 govern mutually exclusive subject matter and cannot be construed in pari materia. Ripley v. Day, 141 N.C. App. 546, 539 S.E.2d 384, 2000 N.C. App. LEXIS 1414 (2000), cert denied, 353 N.C. 380, 547 S.E.2d 415 (2001).

Former statute had no application in cases of intestacy. Vinson v. Chappell, 3 N.C. App. 348, 164 S.E.2d 631 (1968), aff'd, 275 N.C. 234, 166 S.E.2d 686 (1969).

It was only when a spouse died testate that former G.S. 30-1 et seq. became applicable. Vinson v. Chappell, 3 N.C. App. 348, 164 S.E.2d 631 (1968), aff'd, 275 N.C. 234, 166 S.E.2d 686 (1969).

Purpose of Statute. — The apparent purpose of former G.S. 30-1 to deny a surviving spouse a share of the testator's "net estate" when he or she had been adequately provided for by property passing outside the probate estate. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Right Conferred by Statute. — The right of a husband or wife to dissent from the will of his spouse was conferred by statute and could be under former G.S. 30-1 exercised at the time and in the manner fixed by statute. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

Husband and Wife Have Same Rights. — Session Laws 1963, c. 1209 was enacted to abrogate the effect of the decision in Dudley v. Staton, 257 N.C. 572, 126 S.E.2d 590 (1962), and to make the rights of husbands and wives the same in each other's separate property. Fullam v. Brock, 271 N.C. 145, 155 S.E.2d 737 (1967).

Assignment of Reason Not Required. — The surving spouse in the exercise of the right to dissent under former G.S. 30-1 was not required to assign any reason therefor. In re Estate of Cox, 32 N.C. App. 765, 233 S.E.2d 926, cert. denied, 292 N.C. 729, 235 S.E.2d 783 (1977).

The right of a widow to dissent from the will pursuant to former G.S. 30-1 was given by law, and she could exercise such right within the time fixed by statute without assigning any reason therefor. Union Nat'l Bank v. Easterby, 236 N.C. 599, 73 S.E.2d 541 (1952); In re Estate of Kirkman, 38 N.C. App. 515, 248 S.E.2d 438 (1978), cert. denied, 296 N.C. 584, 254 S.E.2d 31 (1979).

Former § 30-1 conferred no right of dower or year's support; these rights existed independently. Overton v. Overton, 259 N.C. 31, 129 S.E.2d 593 (1963).

Rights Analogous to Former Right of Dower. — The rights devolving after the allocation by the commissioners of the spouse's share after a dissent (claim of elective share) is analogous to the rights which devolved upon a widow in the allocation of her dower before its abolishment. Etheridge v. Etheridge, 41 N.C. App. 44, 255 S.E.2d 729 (1979), cert. denied, 299 N.C. 735, 267 S.E.2d 660 (1980).

Limitation on Right. — Right to dissert under former provisions was limited to those cases in which provisions under the will, when added to the value of property passing outside the will as a result of the testator's death, (1) were less than the intestate share, or (2) were less than one half of the net estate if neither lineal descendant nor parent survived. North Carolina Nat'l Bank v. Stone, 263 N.C. 384, 139 S.E.2d 573 (1965).

Right Not an Obligation. — The right to dissent was not an obligation to dissent. Moveover, it was a common principle of law that a surviving spouse had to elect between taking under a will and dissenting from the will, and the election of one precluded the other. Tarlton v. Stidham, 122 N.C. App. 77, 469 S.E.2d 38 (1996).

Right Not Contingent. — Although under prior law the right to take property after dissenting from a will must be established, it was not a contingent right. Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

Testator Presumed to Have Known of Surviving Spouse's Right. — In making a will a husband is presumed to have knowledge of and to have taken into consideration the statutory right of his widow under former G.S. 30-1 to dissent from the will. Keesler v. North Carolina Nat'l Bank, 256 N.C. 12, 122 S.E.2d 807 (1961); Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

And a testator can prevent his will from being upset by giving his surviving spouse the minimum provision required by statute, which may be satisfied in whole or in part by a life estate or life income interest. In re Estate of Finch, 97 N.C. App. 489, 389 S.E.2d 126 (1990).

Election Required under Prior Statutes. — Under prior statutes, surviving spouse had to elect between taking under a will and dissenting from the will. The spouse could not do both; the election of one precludes the other. Hill v. Smith, 51 N.C. App. 670, 277 S.E.2d 542, cert. denied, 303 N.C. 543, 281 S.E.2d 392 (1981).

Dissenting Widow Could Not Assert Any Benefits under Will. — Widow's dissent from her husband's will under former G.S. 30-1 et seq. was a rejection of it as far as her rights were concerned, and having elected to treat it as a nullity, she could not assert any benefits thereunder, even in regard to direction in the will for the payment of estate taxes. Wachovia Bank & Trust Co. v. Green, 236 N.C. 654, 73 S.E.2d 879 (1953), commented on in 31 N.C.L. Rev. 491 (1953).

The act of qualifying as administratrix c.t.a. did not constitute an election to take under the will so as to bar the statutory right of dissent under prior statutes, when at the time of qualification as administratrix c.t.a., the widow was 69 years old, had not communicated with her deceased husband for 18 years, was not accomplished in business affairs on the administration of estates and did not have the assistance of legal counsel. Hurdle v. Sawyer, 46 N.C. App. 814, 266 S.E.2d 404 (1980).

Effect of Dissent on Provisions of Will. — A widow having dissented from her husband's will under former G.S. 30-1 et seq. was entitled to exactly the same share in his estate she would have received if he had died intestate. So far as her property rights in her husband's estate were concerned there was no will. In all other respects the will remained and the executors were controlled by its terms. Wachovia Bank & Trust Co. v. Green, 236 N.C. 654, 73 S.E.2d 879 (1953), commented on in 31 N.C.L. Rev. 491 (1953).

Dissent Held to Bar Other Actions. — Plaintiff's dissent to her husband's will, under former G.S. 30-1, which was subject only to an essentially ministerial act by the clerk of court in approving a valuation agreement, precluded her from maintaining an action for construction of the will or claiming property passing under the residuary clause of the will. Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980).

Effect on Remainder. — Widow's dissent from will under former G.S. 30-1 et seq. was held to terminate her life estate thereunder and accelerate the vesting of remainder. Union Nat'l Bank v. Easterby, 236 N.C. 599, 73 S.E.2d 541 (1952).

Dissent of surviving spouse, so far as remaindermen are concerned, is equivalent to her death. Keesler v. North Carolina Nat'l Bank, 256 N.C. 12, 122 S.E.2d 807 (1961).

Separate Agreement with Remaindermen. — The fact that widow's unconditional dissent from will under former G.S. 30-3.1 and election to take her statutory rights was based upon separate agreement with the vested remaindermen that they pay her a specified sum, did not affect the validity of the dissent, the dissent being valid unless she was induced to dissent in ignorance of her rights to her prejudice. Union Nat'l Bank v. Easterby, 236 N.C. 599, 73 S.E.2d 541 (1952).

Personal Representative Who Was Surviving Spouse Need Not Resign While Right Is Determined. — The personal representative need not resign from that position during the time the right to dissent under former G.S. 30-1 was being determined. North Carolina Nat'l Bank v. Stone, 263 N.C. 384, 139 S.E.2d 573 (1965).

And Failure to Resign Is Not Waiver of Right. — The failure of the surviving spouse to resign as personal representative during the time the right to dissent under former G.S. 30-1 was determined could not constitute a waiver of the right. North Carolina Nat'l Bank v. Stone, 263 N.C. 384, 139 S.E.2d 573 (1965).

Right of Widow Who Offered Will and Was Appointed Executrix. — Under prior statutes, widow who offered a will for probate and qualified as executrix thereunder, and entered upon the duties of her office, or knowingly took property thereunder, could not afterwards be allowed to resign and dissent from said will, unless it appeared that such widow was at the time mentally and physically disqualified from attending to the business in hand or having any intelligent concept of what she was about. Joyce v. Joyce, 260 N.C. 757, 133 S.E.2d 675 (1963).

As to decisions under former law, see also Cheshire v. McCoy, 52 N.C. 376 (1860); Jones v. Gerock, 59 N.C. 190 (1861); Hinton v. Hinton, 61 N.C. 410 (1868); Ramsour v. Ramsour, 63 N.C. 231 (1869); Hinton v. Hinton, 68 N.C. 100 (1873); Arrington v. Dorten, 77 N.C. 367 (1877); Yorkly v. Stinson, 97 N.C. 236, 1 S.E. 452 (1887); Horton v. Lee, 99 N.C. 227, 5 S.E. 404 (1888); Hollomon v. Hollomon, 125 N.C. 29, 34 S.E. 99 (1899); Richardson v. Justice, 125 N.C. 409, 34 S.E. 441 (1899); Trustees of Baptist Female Univ. v. Borden, 132 N.C. 476, 44 S.E. 47 (1903); Perkins v. Brinkley, 133 N.C. 86, 45 S.E. 465 (1903); Lee v. Giles, 161 N.C. 541, 77 S.E. 852 (1913); Atlantic Trust & Banking Co. v. Stone, 176 N.C. 270, 97 S.E. 8 (1918); In re Smith's Estate, 226 N.C. 169, 37 S.E.2d 127 (1946).

B. Lineal Descendants.

The term "lineal descendants" is defined at G.S. 29-2(4) as "all children of such person"; this would include even illegitimate children of a deceased female, under G.S. 29-19(a), and clearly includes adopted children, pursuant to G.S. 29-17. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

The phrase "lineal descendants" is generally applied not to distinguish between children of various marriages or out of wedlock, but to distinguish children from other collateral descendants, e.g., nieces and nephews. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Adopted Children as Lineal Descendants. — Natural children of one spouse born during a previous marriage, if adopted by second spouse with the consent of their surviving natural parent, would be considered lineal descendants by the second marriage for the purposes of former G.S. 30-3(b), which determined a dissenting spouse's share. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Applying G.S. 48-23(1), children adopted must be treated legally as having been born at the time of the order of adoption; accordingly, children in question were as a matter of law born of decedent's second marriage, and were "lineal descendants by the second marriage" within the intended meaning of former G.S. 30-3(b). In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

The natural children of a testatrix, born of a previous marriage and duly adopted by her second husband, would be considered to be her lineal descendants by the second marriage for purposes of determining the second spouse's distributive share upon his dissent from the testatrix's will pursuant to former G.S. 30-3(b). In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

More Testamentary Freedom Allowed to Spouse with Lineal Descendants by First Marriage Only. — The real effect of former G.S. 30-3 was to allow a spouse who left a child or other lineal descendant by a previous marriage but none by the spouse who survived him more testamentary freedom than he would have had otherwise. It was not for the Court of Appeals to "second guess" the General Assembly on the wisdom of this distinction. The court believed the statute was enacted in good faith and it created a classification based upon real distinctions which were not unreasonable. Vinson v. Chappell, 3 N.C. App. 348, 164 S.E.2d 631 (1968), aff'd, 275 N.C. 234, 166 S.E.2d 686 (1969).

Establishment of Right When Spouse and Lineal Descendant Survive. — Under prior statutes where the testator was survived by his spouse and a lineal descendant, the right of the surviving spouse to dissent was established by the determination and comparison of two figures: (1) the aggregate value of property passing under the will and outside the will to the surviving spouse: and (2) the intestate share of the surviving spouse. Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), 296 N.C. 590, 252 S.E.2d 761 (1979).

C. Second or Successive Spouse.

Intent of the legislature in enacting former G.S. 30-3(b) was to enable a person who had a child or lineal descendant by a former marriage to make greater provision for such child or lineal descendant. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

While the legislative purpose of former G.S. 30-3(b) was not entirely clear, it was apparently passed to protect a testator's children by a former marriage against a "fortune-hunting" second or successive spouse. In re Estate of Edwards, 77 N.C. App. 302, 335 S.E.2d 39 (1985), aff'd, 316 N.C. 698, 343 S.E.2d 913 (1986).

Former G.S. 30-3(b) was enacted for the protection of a testator's children by a former spouse, on the assumption that a second or successive spouse would not feel as compelled to provide for the stepchildren upon testator's death as would the testator in his will. In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

When Former § 30-3(b) was Applicable. — Former G.S. 30-3(b) was applicable when the decedent was survived by a child or lineal descendant of a former marriage, even if the decedent's will left nothing to such child or lineal descendant. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

Former G.S. 30-3(b) applied to limit the share of a surviving spouse to one half the intestate share only when (1) a married person died testate survived by his spouse, (2) the surviving spouse, being entitled under former G.S. 30-1 to do so, dissented, (3) the surviving spouse was a "second or successive spouse," (4) no lineal descendants by the second or successive marriage survived the testator, and (5) the testator was survived by lineal descendants by his former marriage. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

Facts Not Considered as to Applicability of Former § 30-3(b). — Whether former G.S. 30-3(b) applied did not depend at all upon such considerations as: (1) the comparative durations of the first and second marriage; (2) whether the former marriage was terminated by death or by divorce; (3) the age(s) of the child or children of the former marriage at the time of the second or successive marriage; and (4) the age(s) of the child or children of the former marriage and their financial status at the time of the death of the decedent. Vinson v. Chappell, 275 N.C. 234, 166 S.E.2d 686 (1969).

Wife's failure to "join" in her husband's petition for adoption of her two minor children by a previous marriage in no way affected her relationship with the children and was immaterial to a determination of her husband's distributive share under former G.S. 30-3(b). In re Estate of Edwards, 316 N.C. 698, 343 S.E.2d 913, rehearing denied, 317 N.C. 704, 347 S.E.2d 40 (1986).

The right of a "second or successive spouse" to dissent under former G.S. 30-1 was determined by former G.S. 30-1(a)(1) without reference to former G.S. 30-3(b). Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

D. Federal Estate Tax.

Estimate of federal estate tax required by former G.S. 30-1(a) was not an estimate of the actual tax which would be paid on the estate, but rather, an estimate of the tax which would be paid if plaintiff received the share of the "net estate" specified by former G.S. 30-1(a)(1), including any marital deduction the estate would receive as a result of her taking that share. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

For purposes of determining whether a surviving spouse could dissent under former G.S. 30-1, it was an estimation of the federal estate tax which had to be deducted in approximating the "net estate." Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Interest and penalties on federal estate tax were not to be considered when computing the "net estate" for the purpose of determining whether a surviving spouse could dissent under former G.S. 30-1. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

When Dissenting Widow Takes Share

Free of Federal Estate Tax. — Under former G.S. 30-1, et seq., the only instance where a surviving wife was allowed to take her distributive share free and clear of the federal estate tax would occur when her husband died testate, leaving no lineal descendants or parents surviving him, and she dissented from his will. Tolson v. Young, 260 N.C. 506, 133 S.E.2d 135 (1963); Adams v. Adams, 261 N.C. 342, 134 S.E.2d 633 (1964).

When Share Taken after Federal Estate Taxes. — Under former G.S. 30-1 et seq., childless widow who dissented from the will of her husband who was survived also by one or more lineal descendants by a former marriage would take her statutory share of the estate computed after the deduction of the federal estate taxes. Tolson v. Young, 260 N.C. 506, 133 S.E.2d 135 (1963).

§ 30-3.2. Definitions.

The following definitions apply in this Article:

(1) "Code" means the Internal Revenue Code in effect at the time of the decedent's death.

(2) "Death taxes" means any estate, inheritance, succession, and similar taxes imposed by any taxing authority, reduced by any applicable credits against those taxes.

(3) "Nonadverse trustee" means:
  a. Any person who does not possess a substantial beneficial interest in the trust that would be adversely affected by the exercise or nonexercise of the power that the individual trustee possesses respecting the trust;
  b. Any person subject to a power of removal by the surviving spouse with or without cause; or
  c. Any company authorized to engage in trust business under the laws of this State, or that otherwise meets the requirements to engage in trust business under the laws of this State.

(4) "Total Net Assets" means, after the payment or provision for payment of the decedent's funeral expenses, year's allowances to persons other than to the surviving spouse, debts, claims other than an equitable distribution of property awarded to the surviving spouse pursuant to G.S. 50-20 subsequent to the death of the decedent, and administration expenses, the sum of the following:
  a. All property to which the decedent had legal and equitable title immediately prior to death;
  b. All property received by the decedent's personal representative by reason of the decedent's death, other than wrongful death proceeds;
  c. One-half of the value of any property held by the decedent and the surviving spouse as tenants by the entirety, or as joint tenants with rights of survivorship;
  d. The entire value of any interest in property held by the decedent and another person, other than the surviving spouse, as joint tenants with right of survivorship, except to the extent that contribution can be proven by clear and convincing evidence;
  e. The value of any property which would be included in the taxable estate of the decedent pursuant to sections 2033, 2035, 2036, 2037, 2038, 2039, or 2040 of the Code.
  f. Any gifts of property made by the decedent to donees other than the surviving spouse within six months of the decedent's death, excluding:
    1. Any gifts within the annual exclusion provisions of section 2503 of the Code;
    2. Any gifts to which the surviving spouse consented. A signing of a deed, or income or gift tax return reporting such gift shall be considered consent; and

3. Any gifts made prior to marriage;

g. Any proceeds of any individual retirement account, pension or profit-sharing plan, or any private or governmental retirement plan or annuity of which the decedent controlled the designation of beneficiary, excluding any benefits under the federal social security system;

h. Any other Property Passing to Surviving Spouse under G.S. 30-3.3; and

i. In case of overlapping application of the same property under more than one provision, the property shall be included only once under the provision yielding the greatest value. (2000-140, s. 92; 2000-178, s. 2; 2001-364, s. 4; 2001-487, s. 16; 2003-296, s. 2.)

Editor's Note. — Subdivisions (3) and (4)f, as amended by Session Laws 2003-296, s. 2, effective January 1, 2004, are applicable to estates of decedents dying on or after that date.

Legal Periodicals. — For recent development, "Death and the Partnership Principle: Interpreting Recent Abatement Amendments to North Carolina's Equitable Distribution Act," see 80 N.C.L. Rev. 1089 (2002).

CASE NOTES

Cited in In re Estate of Archibald, — N.C. App. —, 644 S.E.2d 264, 2007 N.C. App. LEXIS 1046 (2007).

§ 30-3.3. Property passing to surviving spouse.

(a) Property Passing to Surviving Spouse. — For purposes of this Article, "Property Passing to Surviving Spouse" means the sum of the following:

(1) One-half of the value of any interest in property held by the decedent and the surviving spouse as tenants by the entirety or as joint tenants with rights of survivorship;

(2) The value of any interest in property (outright or in trust, including any interest subject to a general power of appointment held by the surviving spouse, as defined in section 2041 of the Code) devised by the decedent to the surviving spouse, or which passes to the surviving spouse by intestacy, or by beneficiary designation, or by exercise of or in default of the exercise of the decedent's testamentary general or limited power of appointment, or by operation of law or otherwise by reason of the decedent's death, excluding any benefits under the federal social security system;

(3) Any year's allowance awarded to the surviving spouse;

(4) The value of any property renounced by the surviving spouse;

(5) The value of the surviving spouse's interest, outright or in trust, in any life insurance proceeds on the life of the decedent;

(6) The value of any interest in property, outright or in trust, transferred from the decedent to the surviving spouse during the lifetime of decedent for which (i) a gift tax return is timely filed reporting such gift, or (ii) the surviving spouse signs a statement acknowledging such a gift. For purposes of this subdivision, any gift to the surviving spouse by the decedent of the decedent's interest in any property held by the decedent and the surviving spouse as tenants by the entirety or as joint tenants with right of survivorship shall be valued at one-half of the entire value of that interest in property at the time the gift is made;

(7) Notwithstanding any other provision of law related to valuing a partial interest in property, the entire fair market value of any

property held in trust for the exclusive benefit of the surviving spouse during the surviving spouse's lifetime, if the terms of the trust meet the following requirements:

a. During the lifetime of the surviving spouse, the trust is controlled by one or more Nonadverse Trustees;

b. The trustee is required to distribute to or for the benefit of the surviving spouse either (i) the entire net income of the trust at least annually; or (ii) the income of the trust in such amounts and at such times as the trustee, in its discretion, determines necessary for the health, maintenance, and support of the surviving spouse;

c. The trustee is required to distribute to or for the benefit of the surviving spouse out of the principal of the trust such amounts and at such times as the trustee, in its discretion, determines necessary for the health, maintenance, and support of the surviving spouse; and

In exercising discretion, the trustee may be authorized or required to take into consideration all other income, assets, and other means of support as are available to the surviving spouse; and

(8) The net value of the marital estate awarded to the surviving spouse pursuant to G.S. 50-20 subsequent to the death of the decedent.

(b) Death Taxes. — The value of Property Passing to Surviving Spouse shall be reduced by any death taxes that are a charge against or apportioned against the surviving spouse on property interests included in Property Passing to Surviving Spouse.

(c) No Duplication. — In case of overlapping application of the same property under more than one provision, the property shall be included only once, under the provision yielding the greatest value. (2000-178, s. 2; 2001-364, s. 5; 2003-296, s. 3.)

Editor's Note. — Subdivision (a)(7), as amended by Session Laws 2003-296, s. 3, effective January 1, 2004, is applicable to estates of decedents dying on or after that date.

Legal Periodicals. — For recent development, "Death and the Partnership Principle: Interpreting Recent Abatement Amendments to North Carolina's Equitable Distribution Act," see 80 N.C.L. Rev. 1089 (2002).

CASE NOTES

I. Decisions under Current Law.
II. Decisions under Prior Law.

I. DECISIONS UNDER CURRENT LAW.

Cited in In re Estate of Archibald, — N.C. App. —, 644 S.E.2d 264, 2007 N.C. App. LEXIS 1046 (2007).

II. DECISIONS UNDER PRIOR LAW.

Editor's Note. — *The cases below were decided under former G.S. 30-1 to 30-3 and corresponding prior provisions, relating to the right to dissent.*

Chapter 29 Governs Intestate Share. — The determination of a surviving spouse's intestate share is governed in the first instance by the "Intestate Succession Act," Chapter 29, G.S. 29-1 et seq. Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), rev'd on other grounds, 296 N.C. 590, 252 S.E.2d 761 (1979).

"Intestate share," as used in former G.S. 30-1, means the amount of real and personal property that the surviving spouse would receive under the provisions of Chapter 29, G.S. 29-1 et seq., known as the Intestate Succession Act, if her husband had died intestate. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969); Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

The term "intestate share," as used in former § 30-1(a)(1), was clear and unambiguous. The fact that the legislature provided one criterion for determining whether the right to dissent existed and another for determining the consequences of the dissent created no ambiguity. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

And Would Not Be Defined with References to Consequences of Dissent. — The 1975 amendment which added subdivision (a)(3) of former G.S. 30-1, cases where the surviving spouse is a second or successive spouse and the testator has surviving him lineal descendants by a former marriage and there are no lineal descendants surviving him by the second or successive marriage, did not manifest that the General Assembly's intent that the term "intestate share" in subdivision (a)(1) of the section be defined with reference to the consequences of the dissent. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Year's Allowance Not Part of Intestate Share. — The year's allowance for the surviving spouse under the provisions of G.S. 30-15 is not a part of the "intestate share" passing to a surviving spouse under the provisions of Chapter 29, G.S. 29-1 et seq., known as the Intestate Succession Act. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

Nor Is Entirety Property, Insurance, or Joint Accounts with Survivorship. — "Intestate share" does not include any property received by the surviving spouse as a tenant by entirety, or from insurance contracts, or from joint accounts with right of survivorship. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

§ 30-3.4. Procedure for determining the elective share.

(a) Exercisable Only During Lifetime. — The right of the surviving spouse to file a claim for an elective share must be exercised during the lifetime of the surviving spouse, by the surviving spouse, the surviving spouse's agent under a power of attorney, or the guardian of the surviving spouse's estate. If a surviving spouse dies before the claim for an elective share has been settled, the surviving spouse's personal representative shall succeed to the surviving spouse's rights to an elective share.

(b) Time Limitations. — A claim for an elective share must be made within six months after the issuance of letters testamentary or letters of administration in connection with the will or intestate proceeding with respect to which the surviving spouse claims the elective share by (i) filing a petition with the clerk of superior court of the county in which the primary administration of the decedent's estate lies, and (ii) mailing or delivering a copy of that petition to the personal representative of the decedent's estate. A surviving spouse's incapacity shall not toll the six-month period of limitations.

(c) Time for Hearing. — Unless waived by the personal representative and the surviving spouse, the clerk shall set the matter for hearing no earlier than two months and no later than six months after the filing of the petition. However, the clerk may extend the time of hearing as the clerk sees fit. The surviving spouse shall give notice of the hearing to the personal representative, and to any person described in G.S. 30-3.5 who may be required to contribute toward the satisfaction of the elective share.

(d) Preparation of Tax Form. — In every case in which a petition to determine an elective share has been filed, and within two months of the filing of the petition, the personal representative shall prepare and submit to the clerk a proposed Form 706, federal estate tax return, for the estate, regardless of whether that form is required to be filed with the Internal Revenue Service. The clerk may extend the time for submission of the proposed Form 706 as the clerk sees fit.

(e) Valuation. — The valuation of interests in property for purposes of G.S. 30-3.2 and G.S. 30-3.3 shall be determined as follows:

(1) Basic principles. — Each interest shall be valued at its fair market value, reduced by all liens, claims, or encumbrances against the interest. For interests passing at the decedent's death, valuation shall be as of the date of death, and for interests transferred during the decedent's lifetime, valuation shall be as of the date of transfer.

(2) Valuation of partial and contingent interests in property. — The valuation of interests in property, outright or in trust, which are

limited to commence or terminate upon the death of one or more persons, upon the expiration of a period of time, or upon the occurrence of one or more contingencies, shall be determined by computations based upon the mortuary and annuity tables set forth in G.S. 8-46 and G.S. 8-47, and upon the basis of six percent (6%) of the gross value of the underlying property in which those interests are limited. However, in valuing interests passing to the surviving spouse, the following special rules apply:

a. An interest described in G.S. 30-3.3(a)(7) that shall be valued as if the underlying property or interest passed outright to the surviving spouse unencumbered by any trust;

b. To the extent that the interest is dependent upon the occurrence of any contingency that is not subject to the control of the surviving spouse and that is not subject to valuation by reference to the mortuary and annuity tables set forth in G.S. 8-46 and G.S. 8-47, the contingency will be conclusively presumed to result in the lowest possible value passing to the surviving spouse. However, a life estate or income interest that will terminate only upon the earlier of the surviving spouse's death or remarriage will be valued without regard to the possibility of termination upon remarriage; and

c. To the extent that the valuation of an interest is dependent upon the life expectancy of the surviving spouse, that life expectancy shall be conclusively presumed to be no less than 10 years, regardless of the actual attained age of the surviving spouse at the decedent's death.

(3) Determination of fair market value. — The fair market value of each asset comprising Total Net Assets shall be determined as follows:

a. Probate assets and assets passing to spouse. — The value of each probate asset and Property Passing to Surviving Spouse, other than assets held in trust, shall be established by the good faith agreement of the surviving spouse and the personal representative, unless either (i) the surviving spouse is the personal representative, or (ii) the clerk determines that the personal representative may not be able to represent the estate adversely to the surviving spouse.

b. Trust assets. — The value of each trust asset shall be established by good faith agreement of the surviving spouse and the trustee, unless either (i) the surviving spouse is the trustee, or (ii) the clerk determines that the trustee may not be able to represent the trust adversely to the surviving spouse.

c. Other assets. — The value of any other asset shall be established by the good faith agreement of the surviving spouse and each person described in G.S. 30-3.5 who may be required to contribute toward the satisfaction of the elective share because of that person's interest in the asset, unless the clerk determines that valuation under sub-subdivision d. of this subdivision is more appropriate.

d. Use of disinterested persons. — If the value of any asset is not established by agreement, the clerk shall appoint one or more qualified and disinterested persons to determine a value of each asset. That determination of the value of an asset shall be final for the exclusive purposes of this Article.

(f) Findings and Conclusions. — After notice and hearing, the clerk shall determine whether or not the surviving spouse is entitled to an elective share, and if so, the clerk shall then determine the elective share and shall order the personal representative to transfer that amount to the surviving spouse. The clerk's order shall recite specific findings of fact and conclusions of law in arriving at the decedent's Total Net Assets, Property Passing to Surviving Spouse, and the elective share.

(g) Appeals. — Any party in interest may appeal from the decision of the clerk to the superior court. If an appeal is taken from the decision of the clerk, that appeal shall have the effect of staying the judgment and order of the clerk until the cause is heard and determined by the superior court upon the appeal taken. Upon an appeal taken from the clerk to the superior court, the judge may review the findings of fact by the clerk and may find the facts or take other evidence, but the facts found by the judge shall be final and conclusive upon any appeal to the Appellate Division. (2000-178, s. 2; 2003-296, s. 4.)

Editor's Note. — Subsections (b) and (e), as amended by Session Laws 2003-296, s. 4, effective January 1, 2004, are applicable to estates of decedents dying on or after that date.

CASE NOTES

- I. Decisions under Prior Law.
  - A. In General.
  - B. Time Limitations.
  - C. Valuation.

I. DECISIONS UNDER PRIOR LAW.

A. In General.

Editor's Note. — *The cases below were decided under former G.S. 30-1 to 30-3 and corresponding prior provisions, relating to the right to dissent.*

Legislative Policy. — Former G.S. 30-2(b), relating to how and by whom dissent could be given, was an expression of legislative policy which the Court of Appeals would not vitiate. In re Estate of Burleson, 24 N.C. App. 136, 210 S.E.2d 114 (1974).

The legislature has created a two-step process to be used when a surviving spouse attempts to dissent from a deceased spouse's will (claim an elective share): the first step is to determine if the surviving spouse has the right to dissent (to claim an elective share), and the second step is to determine the consequences. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990); Funk v. Masten, 121 N.C. App. 364, 465 S.E.2d 322 (1996).

Widow Required to Comply with Statute. — Although a will gave a widow nothing, she was nevertheless required to comply with former section. First-Citizens Bank & Trust Co. v. Willis, 257 N.C. 59, 125 S.E.2d 359 (1962).

Dissent signed by a subscribing witness did not comply with former § 30-2(b). In re Estate of Burleson, 24 N.C. App. 136, 210 S.E.2d 114 (1974).

To hold that the signature by a subscribing witness satisfied the acknowledgment required by former G.S. 30-2(b) would constitute judicial repeal of the 1959 amendment of that section, which provided for acknowledgment of dissents. In re Estate of Burleson, 24 N.C. App. 136, 210 S.E.2d 114 (1974).

The guardian of an incompetent widower was authorized to file a dissent by him from his wife's will under former G.S. 30-2. Fullam v. Brock, 271 N.C. 145, 155 S.E.2d 737 (1967).

Filing Creates Vested Right. — The timely and correct filing of a proper dissent under former G.S. 30-1 et seq. constituted an exercise of the right to dissent and created a vested property right in the dissenting spouse. Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

The dissenting spouse, upon filing dissent to the will under former G.S. 30-1 et seq., became vested, eo instanti, as of the date of the testator's death, with title to the intestate share of the testator's realty which was allowed by the statutes providing therefor. Etheridge v. Etheridge, 41 N.C. App. 44, 255 S.E.2d 729 (1979), cert. denied, 299 N.C. 735, 267 S.E.2d 660 (1980).

Prompt Determination of Right. — The legislature intended for the right to dissent under former G.S. 30-1 et seq. to be determined as quickly as possible after the dissent was filed. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Sufficiency of Marital Trust. — Where under the terms of a trust established for his wife by the testator, the trustee was required to fund the trust with assets which would give wife a life income the value of which (when added to the value of other assets passing to wife under and outside the will) would be equal to her intestate share, and there were no allegations or evidence that the assets of the estate were insufficient to meet this requirement, the marital trust established for wife was not insufficient, as a matter of law, to defeat her right of dissent under former law. In re Estate of Finch, 97 N.C. App. 489, 389 S.E.2d 126 (1990).

Surviving Spouse Held to Have No Right to Dissent. — Under prior statutes, where surviving spouse under will received all of his deceased wife's personal property and, outside the will, received real property owned by the entireties, which was all the real property, he had no right to dissent, because he received everything that he would have received had his wife died without a will. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

Notice to Executor of Intentions of Dissenting Spouse. — The giving of notice of dissent to the clerk of superior court under former G.S. 30-2(a) was sufficient to alert the executor with respect to the intentions of the dissenting spouse and afford him ample opportunity to prepare for a hearing on the question of the spouse's statutory right to dissent under former G.S. 30-1. In re Estate of Kirkman, 38 N.C. App. 515, 248 S.E.2d 438 (1978), cert. denied, 296 N.C. 584, 254 S.E.2d 31 (1979).

Duty of Clerk to Record Filing. — While former G.S. 30-2 merely required filing of dissent, it was the duty of the clerk to record the dissent when filed. Philbrick v. Young, 255 N.C. 737, 122 S.E.2d 725 (1961).

Effect of Recording. — Recording creates the presumption that the instrument was the act of the widow done in the time and manner required by law. Philbrick v. Young, 255 N.C. 737, 122 S.E.2d 725 (1961).

B. Time Limitations.

Former § 30-2 was a statute of limitation, not an enabling statute. The period provided a widow to dissent from her husband's will was not a condition precedent to that right, but merely limited the time in which she could resort to the courts to enforce it. Whitted v. Wade, 247 N.C. 81, 100 S.E.2d 263 (1957); Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980).

Former G.S. 30-2 was a statute of limitations. It extinguished no right, but limited the time in which a widow could enforce the right the law gave her to participate in her husband's estate. First-Citizens Bank & Trust Co. v. Willis, 257 N.C. 59, 125 S.E.2d 359 (1962).

Filing Procedure Not Determinative of Right. — The filing procedure prescribed by former G.S. 30-3.4(a) was merely a limitation on the time within which a surviving spouse had to note her dissent of record. It was not conditioned upon or determinative of the right to dissent, which might not be established until some later date. 292 N.C. 729, 235 S.E.2d 783 (1977); Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), rev'd on other grounds, 296 N.C. 590, 252 S.E.2d 761 (1979).

Effect of Failure to File Within Time Specified. — Failure to dissent under former G.S. 30-2 within the time specified did not extinguish the right, it simply barred the action therefor. Overton v. Overton, 259 N.C. 31, 129 S.E.2d 593 (1963).

Time as to When Right Would Arise. — Although a surviving spouse's right to dissent under prior statutes could not be established until a mathematical computation of the value of the deceased spouse's estate was made, the right to dissent generally arose as of the date of the death of the deceased spouse or it never arose. Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

The right time, manner and effect of filing and recording a dissent to a will under former G.S. 30-1 were all matters within the probate jurisdiction of the clerk of superior court. In re Estate of Outen, 77 N.C. App. 818, 336 S.E.2d 436 (1985), cert. denied, 316 N.C. 377, 342 S.E.2d 896 (1986).

To establish the right to dissent, under former G.S. 30-1, a spouse had to make a timely filing, and to show an entitlement to that right. In re Estate of Outen, 77 N.C. App. 818, 336 S.E.2d 436 (1985), cert. denied, 316 N.C. 377, 342 S.E.2d 896 (1986).

Time Limitations of Six Months. — Former G.S. 30-1 allowed a surviving spouse six months from the probate of the will within which to dissent. Joyce v. Joyce, 260 N.C. 757, 133 S.E.2d 675 (1963).

Time Is to Enable Surviving Spouse to Reach Intelligent Conclusion. — Time is allowed by statute to enable the surviving spouse to make an examination into the value of the estate, the debts and liabilities, and for her to come to an intelligent conclusion as to the course she should pursue under all the circumstances that surround her. Joyce v. Joyce, 260 N.C. 757, 133 S.E.2d 675 (1963).

Statute Tolled by Disability. — The six-month period of limitation in former G.S. 30-2 for dissenting from a will in probate was a statute of limitations which could be tolled by G.S. 1-17 for a disability. In re Estate of Owens, 117 N.C. App. 118, 450 S.E.2d 2 (1994).

Appointment of Guardian after Six Months. — Where no guardian for an insane widow was appointed within six months after her husband's will was proved, but one was subsequently appointed and he filed a dissent on her behalf on the day he was appointed, the widow was not barred by the statute of limitations in former G.S. 30-2, but could bring the action through a guardian as within three years after the disability was removed pursuant to G.S. 1-17. Whitted v. Wade, 247 N.C. 81, 100 S.E.2d 263 (1957).

Statute Ran Against Insane Widow from

Appointment of Guardian. — The statute of limitation provided in former G.S. 30-2 began to run against an insane widow's right to dissent from the date a guardian was appointed. First-Citizens Bank & Trust Co. v. Willis, 257 N.C. 59, 125 S.E.2d 359 (1962).

Although an insane widow received nothing in the will of her husband, the failure of her guardian to dissent for her within six months of his qualification barred her right of dissent under former G.S. 30-2 at the end of that period. First-Citizens Bank & Trust Co. v. Willis, 257 N.C. 59, 125 S.E.2d 359 (1962).

When Dissent Timely. — Under former G.S. 30-2, so long as the dissent was filed within six months after the issuance of letters testamentary, or extended pursuant to former G.S. 30-2(a), it was timely, regardless of whether the appraisal had been conducted. In re Estate of Cox, 32 N.C. App. 765, 233 S.E.2d 926, cert. denied, 292 N.C. 729, 235 S.E.2d 783 (1977).

Spouse Must File Within Time Limit Although Right Not Finally Established. — A surviving spouse could and, in fact, had to file her dissent under former G.S. 30-1 within the statutory time period even though her right to dissent was not finally established until after the statutory time period had expired due to the necessity of ascertaining "net estate." Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), rev'd on other grounds, 296 N.C. 590, 252 S.E.2d 761 (1979).

C. Valuation.

Constitutionality of Methods of Determining Values. — The values which must be determined under the statutory procedure can be reasonably ascertained by the use of aids such as tax tables and expert witnesses, and the procedure is not constitutionally invalid. The procedure set forth in former statute did not approach that level of arbitrary governmental action necessary to support a claim of denial of due process. In re Estate of Kirkman, 38 N.C. App. 515, 248 S.E.2d 438 (1978), cert. denied, 296 N.C. 584, 254 S.E.2d 31 (1979).

Contributions by Surviving Spouse Excluded. — The plain meaning of former G.S. 30-1 completely excluded any property or interest in property to the extent that the surviving spouse gave, donated, contributed, or paid for it. Funk v. Masten, 126 N.C. App. 529, 485 S.E.2d 890 (1997).

Purposes for Which Established Value Binding under Former Statute. — Any determination and establishment of value made as provided in former G.S. 30-1 was binding only for the purposes of determining whether there was a right of dissent. In re Kirkman, 302 N.C. 164, 273 S.E.2d 712 (1981).

Method for Determining Different Benefits. — Former G.S. 30-1(c) provided a method by which to determine the value of benefits under the will and the benefits in case of intestacy. North Carolina Nat'l Bank v. Stone, 263 N.C. 384, 139 S.E.2d 573 (1965).

Right Mathematically Determined by Value of Property. — Former G.S. 30-1 provided that when values were determined as set out therein, they would be final for determining the right of dissent and should be used exclusively for this purpose. No doubt when this legislation was enacted it was contemplated that the right to dissent would be thus mathematically established. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

Under former § 30-1, if A equalled the aggregate value of provisions under the will for the benefit of the surviving spouse and B equalled the value of property or interests in property passing in any manner outside the will to the surviving spouse as a result of the death of the testator, and C equalled the net estate of the decedent, then the surviving spouse was entitled to dissent from his wife's will if A plus B was less than one-half of C; that is, if A + B < 1/2(C). In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

Under former G.S. 30-1, statutory scheme contemplated that the surviving spouse's right of dissent would be established by a mathematical computation. Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980).

And Right Could Not Be Established Until Property Is Determined and Valued. — In the absence of a determination and valuation of the property passing to the surviving spouse under the will and outside the will as of the date of the death of the deceased spouse as provided by former G.S. 30-1, there could be no proper determination of whether the right to dissent had been established. When the property involved is determined and valued as provided by statute, then the right of dissent can be determined mathematically. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

Where the record was bare of any recitation of values necessary to determine if plaintiff could indeed dissent from decedent's will under former G.S. 30-1, and contained no findings or conclusions as to plaintiff's right to dissent, the issue was not ripe for resolution and was nonjusticiable. Funk v. Masten, 121 N.C. App. 364, 465 S.E.2d 322 (1996).

Property Determined and Valued as of Date of Testator's Death. — Former statute, which permitted dissent in certain instances, also required that the property involved be determined and valued as of the date of death of the testator. The procedure was mandatory. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

Determination Made from Net, Not Gross, Estate. — Former G.S. 30-1(c) did not require the intestate share to be determined, for purposes of establishing the right to dissent, from decedent's gross estate valued as of the date of his death rather than from net estate. Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), rev'd on other grounds, 296 N.C. 590, 252 S.E.2d 761 (1979).

In establishing the right of a surviving spouse to dissent pursuant to former G.S. 30-1(a)(1), the determination of intestate share would be based on the value of the decedent's net estate, as provided in Chapter 29, G.S. 29-1 et seq. Phillips v. Phillips, 34 N.C. App. 428, 238 S.E.2d 790 (1977), rev'd on other grounds, 296 N.C. 590, 252 S.E.2d 761 (1979).

Computation of Net Estate. — To ascertain "net estate" under G.S. 29-2(5), it is necessary to subtract from the value of the gross estate, "family allowances, costs of administration, and all lawful claims against the estate." Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Since the intestate share of any surviving spouse, or other heir, is ordinarily a percentage of the decedent's net estate, for purposes of former G.S. 30-1, the amount of the net estate had to be determined within limits which would permit the court to ascertain with substantial accuracy whether the value of the intestate share of the surviving spouse was less or greater than the value of the property passing to her in and outside the will. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Value Seldom Determined with Complete Accuracy Prior to Final Account. — Prior to the time the personal representative files his final account, it will seldom, if ever, be possible to determine with complete accuracy the value of the testator's net estate and the intestate share of the surviving spouse. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Estimating Value of Net Estate. — Under former G.S. 30-1, the right to dissent was to be determined by the clerk whenever, in his judgment, the value of the "net estate" could be estimated with reasonable accuracy, rather than such time as the actual value of the net estate could be ascertained, i.e., at the time of distribution. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Property Owned as Tenants by Entirety. — Under former G.S. 30-1, the value of real property owned by couple as tenants by the entirety was not to be included in testatrix's net estate. In re Estate of Francis, 94 N.C. App. 744, 381 S.E.2d 484, rev'd on other grounds, 327 N.C. 101, 394 S.E.2d 150 (1990).

Real property held as tenants by the entirety could not be included in net estate for purposes of determining right to dissent under former G.S. 30-1. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

For purposes of former G.S. 30-1, real property owned by the entireties was included in the value of property passing to surviving spouse outside the will as a result of the death of the testator. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

Funds held by testator-spouse in joint tenancy with right of survivorship with third party established pursuant to G.S. 41-2.1(a) did not become part of testator-spouse's net estate for purposes of former G.S. 30-1. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

Listing Survivorship Accounts on 90-Day Inventory Did Not Make Those Accounts Part of Net Estate. — Fact that executrix listed one-half of funds in survivorship accounts on 90-day inventory to comply with G.S. 41-2.1(b)(3) and (b)(4) did not make the funds part of the net estate for purposes of determining her right to dissent under former G.S. 30-1. In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150 (1990).

Bank Account Held as Joint Tenants. — Where testatrix retained complete control over the assets of the bank account held by herself and her husband as joint tenants with right of survivorship until the moment of her death, public policy expressed in the former dissent statutes would be served by including in the net estate for purposes of the dissent statute the value of the bank accounts. In re Estate of Francis, 94 N.C. App. 744, 381 S.E.2d 484, rev'd on other grounds, 327 N.C. 101, 394 S.E.2d 150 (1990).

Property Given or Paid for by Surviving Spouse. — The plain meaning of former G.S. 30-1 completely excluded any property or interest in property to the extent that the surviving spouse gave, donated, contributed, or paid for it. Once the property was excluded, no other valuation as to that specific property could be made. Funk v. Masten, 126 N.C. App. 529, 485 S.E.2d 890 (1997).

Property Held as Tenants by Entirety and Paid for by Surviving Spouse. — For purposes of calculating the surviving spouse's right to dissent (right to claim an elective share), none of the value of the property owned as tenants by the entirety could be included in the value of property passing outside the will to the surviving spouse when the surviving spouse contributed the total purchase price of the property. Funk v. Masten, 126 N.C. App. 529, 485 S.E.2d 890 (1997).

Federal estate tax was a "lawful claim" against testator's estate, for purposes of former G.S. 30-1 and the widow's intestate share of the estate was to be computed after its deduction. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Variance between Valuations and Ultimate Distributive Share. — The language of former G.S. 30-1(c), which established a valuation procedure for the purpose of establishing the right of dissent and mandated that the value so determined be used exclusively for that purpose, indicated that the General Assembly anticipated a variance between this valuation and the ultimate distributive share. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Clerk's Approval of Valuation Required. — To establish her entitlement to the right of dissent under former G.S. 30-1, surviving spouse was required to obtain the clerk's approval of the value of the property passing to her under and outside her husband's will as of the date of his death. Greene v. Lynch, 51 N.C. App. 665, 277 S.E.2d 454 (1981).

Agreement as to Valuation. — Under former G.S. 30-1, absent a showing that the parties failed to act in an arm's length manner, or that the rights of creditors of the estate would be adversely affected thereby, it was proper for the clerk ought to abide by an agreement as to the valuation of the estate and the testate and intestate shares thereof. Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980).

Agreement Between Personal Representative and Dissenting Spouse as to Net Estate. — Where the testator's personal representative and the dissenting spouse, dealing at arm's length, were able to agree upon the value of the "net estate," the clerk or the court would ordinarily abide by this agreement in determining the right to dissent under former G.S. 30-1. Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979).

Compliance with Statute. — Where plaintiff filed a dissent to her late husband's will, pursuant to former G.S. 30-1, and the administrator with the will annexed and the other devisees under the will implicitly assented to the wife's valuation of the estate and her testate and intestate shares thereof by conceding her right to dissent from the will, the parties complied with the provisions of former G.S. 30-1(c) with respect to an agreement as to valuation except for procuring the approval of the clerk of their valuation. Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980).

§ 30-3.5. Recovery of assets by personal representative.

(a) Recovery of Assets. — The personal representative is entitled to recover proportionately from all persons, other than the surviving spouse, receiving or in possession of any of the decedent's Total Net Assets a sufficient amount to enable the personal representative to pay the elective share. The apportionment shall be made in the proportion that the value of the interest of each person receiving or in possession of any of Total Net Assets bears to Total Net Assets, excluding any Property Passing to Surviving Spouse. The only persons subject to contribution to make up the elective share are (i) original recipients of property comprising the decedent's Total Net Assets, and subsequent gratuitous inter vivos donees or persons claiming by testate or intestate succession to the extent those persons have the property or its proceeds on or after the date of decedent's death, and (ii) a fiduciary, as to the property under the fiduciary's control at or after the time a fiduciary receives notice that a surviving spouse has claimed an elective share. A fiduciary shall not be considered to have notice until it receives notice at its address as shown in the decedent's estate papers in the clerk's office or, if there are no such papers or no such address is shown in those papers, at the fiduciary's residence or the office of its registered agent.

The personal representative may withhold from any property of the decedent in his possession, distributable to any person subject to apportionment, the amount of the elective share apportioned to such person. If the property in possession of the personal representative and distributable to any person subject to apportionment is insufficient to satisfy the proportionate amount of the elective share determined to be due from that person, the personal representative may recover the deficiency from that person. If the property is not in possession of the personal representative, the personal representative may recover from the person the amount of the elective share apportioned to that person in accordance with this Article. If the personal representative cannot reasonably collect from any person subject to apportionment the amount of the elective share apportioned to that person, the amount not reasonably recoverable shall, with the approval of the clerk, be apportioned among the other persons who are subject to apportionment. The apportionment shall be made in the proportion that the value of the interest of each remaining person bears to the total value of the interests of all remaining persons.

(b) Standstill Order. — After the filing of the petition demanding an elective share, either the personal representative or surviving spouse may request the clerk to issue an order that any recipients not dispose of any of the decedent's Total Net Assets pending the hearing. The decision to issue such an order shall be in the discretion of the clerk.

(c) Satisfaction of Liability. — A person receiving or in possession of any of the decedent's Total Net Assets may pay his proportionate elective share liability with respect to that property by any of the following methods:

(1) Conveyance of the property included in the decedent's Total Net Assets;

(2) Payment of the value of his liability in cash or, upon agreement of the surviving spouse, other property; or

(3) Partial conveyance and partial payment under subdivisions (1) and (2) of this subsection, provided the value conveyed and paid is equal to his liability.

(d) Expenses. — The expenses reasonably incurred by the personal representative in connection with the appraisal or recovery of assets shall be apportioned as provided for the elective share under this Article. If the personal representative finds that it is inequitable to apportion the expenses because those expenses were incurred because of the fault of one or more persons subject to apportionment, the personal representative may direct other more equitable apportionment, with the approval of the clerk.

(e) Bond. — If property held by the personal representative is distributed prior to final apportionment of the elective share, the personal representative may require the distributee to provide a bond or other security for the apportionment liability in the form and amount prescribed by the personal representative, with the approval of the clerk. (2000-178, s. 2.)

CASE NOTES

I. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases below were decided under former G.S. 30-1 to 30-3 and corresponding prior provisions, relating to the right to dissent.*

Allocation so as to Cause Least Disruption of Decedent's Plan. — When a surviving spouse dissented from a will under former G.S. 30-1 et seq., the intestate share was to be allocated so as to cause the least possible disruption of the decedent's plan for the distribution of his estate. Insofar as possible the beneficiaries of the will were to receive the property testatrix intended for them to receive. In re Estate of Etheridge, 33 N.C. App. 585, 235 S.E.2d 924, cert. denied, 293 N.C. 253, 237 S.E.2d 535 (1977).

Property from Which General Legacies Come as Asset. — When the property from which general legacies must come provides income, it is a general asset of the estate subject to the payment of debts and disposition under the terms of the will; hence, under former G.S. 30-1 et seq., where a widow dissented, it would be proportionately distributed to her under the applicable statute. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

§ 30-3.6. Waiver of rights.

(a) The right of a surviving spouse to claim an elective share may be waived, wholly or partially, before or after marriage, with or without consideration, by a written waiver signed by the surviving spouse.

(b) A waiver is not enforceable if the surviving spouse proves that:

(1) The waiver was not executed voluntarily; or

(2) The surviving spouse was not provided a fair and reasonable disclosure of the property and financial obligations of the decedent, unless the surviving spouse waived, in writing, the right to that disclosure.

(c) A written waiver that would have been effective to waive a spouse's right to dissent in estates of decedents dying on or before December 31, 2000, under Article 1 of Chapter 30 of the General Statutes is effective to waive that spouse's right of elective share under this Article for estates of decedents dying on or after January 1, 2001. (2000-178, s. 2; 2003-296, s. 5; 2004-203, s. 30.)

CASE NOTES

I. Decisions under Prior Law.

I. DECISIONS UNDER PRIOR LAW.

Editor's Note. *— The cases below were decided under former G.S. 30-1 to 30-3 and corresponding prior provisions, relating to the right to dissent.*

Family settlement agreements are favored by the law; however, such an agreement is invalid unless all who receive under the will join in the agreement. In re Estate of Outen, 77 N.C. App. 818, 336 S.E.2d 436 (1985), cert. denied, 316 N.C. 377, 342 S.E.2d 896 (1986).

Alleged agreement between widow and estate was not a "family settlement agreement," where it was never executed by all of the beneficiaries under the will. In re Estate of Outen, 77 N.C. App. 818, 336 S.E.2d 436 (1985), cert. denied, 316 N.C. 377, 342 S.E.2d 896 (1986).

Release of Right Held Effective. — Although husband's release did not enumerate the statutory right to dissent under former G.S. 30-1, where it did release "all rights or claims of curtesy, inheritance, descent, and distribution and all other rights or claims growing out of the marital relationship between the parties ... [and] all rights in the estate of the said wife, real, personal and mixed, now owned or hereafter acquired by her," this full and final settlement of such rights encompassed the unenumerated statutory right of dissent under former statute. In re Estate of Tucci, 94 N.C. App. 428, 380 S.E.2d 782, cert. denied as to additional issues, 325 N.C. 271, 384 S.E.2d 514 (1989), aff'd, 326 N.C. 359, 388 S.E.2d 768 (1990).

Release Held Not Rescinded by Resumption of Cohabitation. — Where husband and wife's combined separation agreement and property settlement expressly provided that in the event of resumption of cohabitation by the parties the separation agreement and property settlement would remain in full force and effect, and there was no other evidence of rescission, the couple's reconciliation prior to the wife's death did not imply a rescission of husband's release of his right to dissent under former section. In re Estate of Tucci, 94 N.C. App. 428, 380 S.E.2d 782, cert. denied as to additional issues, 325 N.C. 271, 384 S.E.2d 514 (1989), aff'd, 326 N.C. 359, 388 S.E.2d 768 (1990).

ARTICLE 2.

Dower.

§§ 30-4 through 30-8: Repealed by Session Laws 1959, c. 879, s. 14.

Cross References. — As to abolition of the estate of dower, see G.S. 29-4.

§ 30-9: Repealed by Session Laws 1965, c. 853.

Cross References. — For present provisions as to conveyance without joinder of incompetent spouse, see G.S. 39-7.

§ 30-10: Repealed by Session Laws 1959, c. 879, s. 14.

Editor's Note. — The act repealing this section inserted a new Chapter 29 entitled "Intestate Succession."

Article 3.

Allotment of Dower.

§§ 30-11 through 30-14: Repealed by Session Laws 1959, c. 879, s. 14.

Editor's Note. — The act repealing these sections inserted a new Chapter 29 entitled "Intestate Succession."

Article 4.

Year's Allowance.

Part 1. Nature of Allowance.

§ 30-15. When spouse entitled to allowance.

Every surviving spouse of an intestate or of a testator, whether or not he has petitioned for an elective share, shall, unless he has forfeited his right thereto, as provided by law, be entitled, out of the personal property of the deceased spouse, to an allowance of the value of ten thousand dollars ($10,000) for his support for one year after the death of the deceased spouse. Such allowance shall be exempt from any lien, by judgment or execution, acquired against the property of the deceased spouse, and shall, in cases of testacy, be charged against the share of the surviving spouse. (1868-9, c. 93, s. 81; 1871-2, c. 193, s. 44; 1880, c. 42; Code, s. 2116; 1889, c. 499, s. 2; Rev., s. 3091; C.S., s. 4108; 1953, c. 913, s. 1; 1961, c. 316, s. 1; c. 749, s. 1; 1969, c. 14; 1981, c. 413, s. 1; 1995, c. 262, s. 4; 2000-178, s. 4.)

Cross References. — As to allowance to children, see G.S. 30-17. As to property subject to allowance, see G.S. 30-18. As to right of elective share, see G.S. 30-3.1 et seq.

Legal Periodicals. — For brief comment on the 1953 amendment, see 31 N.C.L. Rev. 376 (1953).

For survey of 1978 property law, see 57 N.C.L. Rev. 1103 (1979).

For survey of 1979 property law, see 58 N.C.L. Rev. 1059 (1980).

CASE NOTES

Purely Statutory Right. — The right of a widow to a year's support is purely statutory. Broadnax v. Broadnax, 160 N.C. 432, 76 S.E. 216 (1912). See Drewry v. Raleigh Sav. Bank & Trust Co., 173 N.C. 664, 92 S.E. 593 (1917); Jones v. Callahan, 242 N.C. 566, 89 S.E.2d 111 (1955); Overton v. Overton, 259 N.C. 31, 129 S.E.2d 593 (1963).

Legislative Intent. — The North Carolina Legislature intentionally did not impose a notice requirement with respect to the statutory right to a year's allowance. In re Estate of Archibald, — N.C. App. —, 644 S.E.2d 264, 2007 N.C. App. LEXIS 1046 (2007).

If the wife dies intestate, the husband has the same right as a widow. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

Under this section as rewritten, for the first time in our law a husband may be entitled to a year's allowance. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

Allowance Is Not "Intestate Share". — The year's allowance for the surviving spouse under the provisions of this section is not a part of the "intestate share" passing to a surviving spouse under the provisions of Chapter 29 of the General Statutes, known as the Intestate Succession Act. In re Estate of Connor, 5 N.C. App. 228, 168 S.E.2d 245 (1969).

A widow who has dissented from her husband's will takes her year's allowance in addition to her statutory share in his estate. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

The phrase "and shall, in cases of testacy, be charged against the share of the surviving spouse," refers only to the share of a widow who takes in accordance with the will and has not dissented from it. First Union Nat'l Bank v. Melvin, 259 N.C. 255, 130 S.E.2d 387 (1963).

Priority over Creditors. — The widow is given her right to a year's support against all general creditors, but no better title to the property assigned her than her husband had. She is entitled to her year's allowance in preference to the special lien acquired by an execution bearing teste prior to the husband's death. In regard to other liens and equities, she takes the property in the same manner and plight in which her husband held it. Williams v. Jones, 95 N.C. 504 (1886).

Widow's priority extends over funeral expenses and costs of administration. Denton v. Tyson, 118 N.C. 542, 24 S.E. 116 (1896).

Mortgage Registered after Husband's Death. — Where a husband mortgaged a horse, but the mortgage was not registered until after his death, and prior to its registration the horse was assigned to the widow as a part of her year's support, it was held that the widow took the property subject to the mortgage lien. Williams v. Jones, 95 N.C. 504 (1886); Coastal Sales Co. v. Weston, 245 N.C. 621, 97 S.E.2d 267 (1957).

Will Cannot Deprive Surviving Spouse of Allowance. — The General Assembly did not intend that if the testator left a will under the terms of which the surviving spouse received nothing from his personal property, that the spouse was deprived of an allowance. In re Estate of Brown, 40 N.C. App. 61, 251 S.E.2d 905 (1979).

The General Assembly did not intend that if the deceased left a will under the terms of which the surviving spouse received only what she would have received by law as her own property, that the surviving spouse is deprived of an allowance from the deceased's personal property. In re Estate of Brown, 40 N.C. App. 61, 251 S.E.2d 905 (1979).

Where the decedent left a will under the terms of which his surviving spouse did not receive any legacy from his personal property, she could take her allowance out of his personal property, which would not include the proceeds from an insurance policy or her share of a joint bank account. In re Estate of Brown, 40 N.C. App. 61, 251 S.E.2d 905 (1979).

Proceeds from Joint Bank Account Are Not Personal Property of Decedent. — Proceeds from a joint bank account were paid to a surviving spouse under the terms of the contract setting up the account, and were her property and not the "personal property of the deceased spouse." In re Estate of Brown, 40 N.C. App. 61, 251 S.E.2d 905 (1979).

Deduction of Year's Allowance from Widow's Distributive Share Proper. — G.S. 30-27 merely outlined an alternative procedural method to pursue larger allowances in superior court and should, in all other ways, have been treated in like manner with allowances administered pursuant to G.S. 30-15; there was no error in a trial court's order charging the year's allowance paid to the decedent's widow against the widow's distributive share. Bryant v. Bowers, — N.C. App. —, 641 S.E.2d 855, 2007 N.C. App. LEXIS 583 (2007).

Proceeds from Insurance Policy Are Not Personal Property of Decedent. — Proceeds from an insurance policy were paid to a surviving spouse in accordance with her rights under the insurance contract, and was not the "personal property of the deceased spouse." In re Estate of Brown, 40 N.C. App. 61, 251 S.E.2d 905 (1979).

Award under Will as Estoppel. — Where the widow and the executor by mutual consent selected three men to lay off to the widow her year's support, provided for her in the husband's will, which was done, and both parties assented to the report in writing, it was held that the widow in the absence of fraud and undue influence was estopped by the award and cannot maintain a proceeding under this section. Flippin v. Flippin, 117 N.C. 376, 23 S.E. 321 (1895).

Antenuptial Contract as a Bar. — A widow is barred from recovering a year's support by an antenuptial contract relinquishing all claim to any property of her husband. Perkins v. Brinkley, 133 N.C. 86, 45 S.E. 465 (1903); In re Estate of Cline, 103 N.C. App. 83, 404 S.E.2d 178 (1991).

The portion of a judgment awarding widow a year's allowance and life estate in the marital home was vacated, and the portion of the judgment awarding plaintiff spousal support during deceased husband's incompetency up to the date of his death was affirmed, where prior to marriage, husband and wife entered into an agreement whereby each reciprocally released, renounced and quitclaimed any interest acquired by virtue of the marriage in and to any real or personal property then owned or thereafter acquired, and specifically renounced and disclaimed any right to inherit or participate in the distribution of any real and personal property of the other spouse. In re Estate of Cline, 103 N.C. App. 83, 404 S.E.2d 178 (1991).

Any or all of the marital rights under this section may be surrendered by a properly drawn separation agreement complying with the requirements of former G.S. 52-6. Lane v. Scarborough, 19 N.C. App. 32, 198 S.E.2d 45, rev'd on other grounds, 284 N.C. 407, 200 S.E.2d 622 (1973).

When Husband Dies a Citizen of Another State. — It has been held that the widow of a man who dies a citizen of another state is not entitled to a year's support out of the assets of the decedent in this State, and the fact that she became a citizen of this State after her husband's death is immaterial, since her relations to the estate and her right to share in it are fixed at the intestate's death, and by the laws of his domicile. Simpson v. Cureton, 97 N.C. 112, 2 S.E. 668 (1887). See Medley v. Dunlap, 90 N.C. 527 (1884).

A widow whose husband died domiciled in another state is entitled to her year's support in this State in which there is a fund due her husband, if the widow is a bona fide resident in the State. The reason given for this ruling is that the fiction of personal property being considered as belonging to the domicile of the owner applies only to the distribution of the assets of the one deceased, and has no application to payment of debts, legacies, costs of administration, etc. Jones v. Layne, 144 N.C. 600, 57 S.E. 372 (1907). See also Moye v. May, 43 N.C. 131 (1851), petition to rehear dismissed, 54 N.C. 84 (1853); Kimball v. Deming, 27 N.C. 418 (1845); In re Hayes, 112 N.C. 76, 16 S.E. 904 (1893).

Applied in Cook v. Sexton, 79 N.C. 305 (1878); In re Stewart, 140 N.C. 28, 52 S.E. 255 (1905); In re Trogdon, 330 N.C. 143, 409 S.E.2d 897 (1991).

Cited in Gomer v. Askew, 242 N.C. 547, 89 S.E.2d 117 (1955); Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978); Phillips v. Phillips, 296 N.C. 590, 252 S.E.2d 761 (1979); In re Trogdon, 101 N.C. App. 323, 399 S.E.2d 396 (1991); Brantley v. Watson, 113 N.C. App. 234, 438 S.E.2d 211 (1994).

OPINIONS OF ATTORNEY GENERAL

Widow Who Moved to State after Husband's Death Not Entitled to Allowance. — See opinion of Attorney General to Honorable Fred Proffitt, Clerk of Superior Court, Yancey County, 40 N.C.A.G. 35 (1969).

§ 30-16. Duty of personal representative, magistrate, or clerk to assign allowance.

It shall be the duty of every administrator, collector, or executor of a will, on application in writing, signed by the surviving spouse, at any time within one year after the death of the deceased spouse, to assign to the surviving spouse the year's allowance as provided in this Article.

If there shall be no administration, or if the personal representative shall fail or refuse to apply to a magistrate or clerk of court, as provided in G.S. 30-20, for 10 days after the surviving spouse has filed the aforesaid application, or if the surviving spouse is the personal representative, the surviving spouse may make application to the magistrate or clerk, and it shall be the duty of the magistrate or clerk to proceed in the same manner as though the application had been made by the personal representative.

Where any personal property of the deceased spouse shall be located outside the township or county where the deceased spouse resided at the time of his death, the personal representative or the surviving spouse may apply to any magistrate or to any clerk of court of any township or county where such personal property is located, and it shall be the duty of such magistrate or clerk to assign the year's allowance as if the deceased spouse had resided and died in that township. (1868-9, c. 93, s. 12; 1870-1, c. 263; Code, ss. 2120, 2122; 1889, cc. 496, 531; 1891, c. 13; Rev., ss. 3096, 3098; C.S., ss. 4113, 4115; 1961, c. 749, s. 2; 1971, c. 528, s. 21; 1997-310, s. 1.)

CASE NOTES

Widow's Allowance Is Terminable. — The administrator is only under a duty to assign the year's allowance upon written application of the widow, signed by her, and within one year from the decedent's death and if these requirements are not met, there is no duty to assign the allowance; therefore, it is terminable. Wachovia Bank & Trust Co. v. United States, 234 F. Supp. 897 (M.D.N.C. 1964).

Therefore Not Part of Marital Deduction for Estate Tax Purposes. — The widow's year's allowance being terminable is not part of the marital deduction for estate tax purposes. Wachovia Bank & Trust Co. v. United States, 234 F. Supp. 897 (M.D.N.C. 1964).

Next Friend as Representative of Minor Widow. — In dissenting from her husband's will and applying for a year's allowance, the widow, being a minor without guardian, may be represented by a next friend, duly appointed. Hollomon v. Hollomon, 125 N.C. 29, 34 S.E. 99 (1899).

§ 30-17. When children entitled to an allowance.

Whenever any parent dies survived by any child under the age of 18 years, including an adopted child or a child with whom the widow may be pregnant at the death of her husband, or a child who is less than 22 years of age and is a full-time student in any educational institution, or a child under 21 years of age who has been declared mentally incompetent, or a child under 21 years of age who is totally disabled, or any other person under the age of 18 years residing with the deceased parent at the time of death to whom the deceased parent or the surviving parent stood in loco parentis, every such child shall be entitled to receive an allowance of two thousand dollars ($2,000) for the child's support for the year next ensuing the death of such parent. Such allowance shall be in addition to the child's share of the deceased parent's estate and shall be exempt from any lien by judgment or execution against the property of such parent. The personal representative of the deceased parent shall, within one year after the parent's death, assign to every such child the allowance herein provided for; but if there is no personal representative or if he fails or refuses to act within 10 days after written request by a guardian or next friend on behalf of such child, the allowance may be assigned by a magistrate or clerk of court upon application of said guardian or next friend.

If the child resides with the widow of the deceased parent at the time such allowance is paid, the allowance shall be paid to said widow for the benefit of said child. If the child resides with its surviving parent who is other than the widow of the deceased parent, such allowance shall be paid to said surviving parent for the use and benefit of such child, regardless of whether the deceased died testate or intestate or whether the widow dissented from the will. Provided, however, the allowance shall not be available to an illegitimate child of a deceased father, unless such deceased father shall have recognized the paternity of such illegitimate child by deed, will or other paper-writing. If the child does not reside with a parent when the allowance is paid, the allowance shall be paid to the child's general guardian, if any, and if none, to the clerk of the superior court who shall receive and disburse same for the benefit of such child. (1889, c. 496; Rev., s. 3094; C.S., s. 4111; 1939, c. 396; 1953, c. 913, s. 2; 1961, c. 316, s. 2; c. 749, s. 3; 1969, c. 269; 1971, c. 528, s. 22; 1973, c. 1411; 1975, c. 259; 1981, c. 413, s. 2; c. 599, s. 7; 1995, c. 262, s. 5; 1997-310, s. 2; 2005-225, s. 1.)

Editor's Note. — This section, as amended by Session Laws 2005-225, s. 1, effective October 1, 2005, is applicable to estates of persons dying on or after that date.

Legal Periodicals. — For background and effect of section, see 17 N.C.L. Rev. 357 (1939).

For brief comment on the 1953 amendment, see 31 N.C.L. Rev. 376 (1953).

CASE NOTES

As to purpose of this and foregoing sections, see Kimball v. Deming, 27 N.C. 418 (1845), approved in In re Hayes, 112 N.C. 76, 16 S.E. 904 (1893).

Section Has Reference Only to Estate of Intestate or to Where Widow Dissents. — This section, by its terms, its history, and when considered with the other provisions of this Article, has reference only to the estate of an intestate or at most to an estate where the widow dissents from the will. Jones v. Callahan, 242 N.C. 566, 89 S.E.2d 111 (1955).

Applied in In re Stewart, 140 N.C. 28, 52 S.E. 255 (1905); Drewry v. Raleigh Sav. Bank & Trust Co., 173 N.C. 664, 92 S.E. 593 (1917).

Cited in Gomer v. Askew, 242 N.C. 547, 89 S.E.2d 117 (1955).

§ 30-18. From what property allowance assigned.

Such allowance shall be made in money or other personal property of the estate of the deceased spouse. (1868-9, c. 93, s. 9; Code, s. 2117; Rev., s. 3095; C.S., s. 4112; 1925, c. 92; 1961, c. 749, s. 4.)

CASE NOTES

Former Law. — For cases construing section prior to the 1961 amendment, see Van Norden v. Prim, 3 N.C. 149 (1801); Hunter v. Husted, 45 N.C. 97 (1852); Irvin v. Hughes, 82 N.C. 210 (1880); Denton v. Tyson, 118 N.C. 542, 24 S.E. 116 (1896); Broadnax v. Broadnax, 160 N.C. 432, 76 S.E. 216 (1912).

Part 2. Assigned by Magistrate or Clerk.

§ 30-19. Value of property ascertained.

The value of the personal property assigned to the surviving spouse and children shall be ascertained by a magistrate or the clerk of court of the county in which administration was granted or the will probated. (1868-9, c. 93, s. 13; Code, s. 2121; Rev., s. 3097; C.S., s. 4114; 1961, c. 749, s. 5; 1971, c. 528, s. 22; 1989, c. 11, s. 1; 1997-310, s. 3.)

§ 30-20. Procedure for assignment.

Upon the application of the surviving spouse, a child by his guardian or next friend, or the personal representative of the deceased, the clerk of superior court of the county in which the deceased resided may assign the inquiry to a magistrate of the county. The clerk of court, or magistrate upon assignment, shall ascertain the person or persons entitled to an allowance according to the provisions of this Article, and determine the money or other personal property of the estate, and pay over to or assign to the surviving spouse and to the children, if any, so much thereof as they shall be entitled to as provided in this Article. Any deficiencies shall be made up from any of the personal property of the deceased, and if the personal property of the estate shall be insufficient to satisfy such allowance, the clerk of the superior court shall enter judgment against the personal representative for the amount of such deficiency, to be paid when a sufficiency of such assets shall come into his hands. (1870-1, c. 263; Code, s. 2122; 1891, c. 13; 1899, c. 531; Rev., s. 3098; C.S., s. 4115; 1961, c. 749, s. 6; 1971, c. 528, s. 23; 1989, c. 11, s. 2; 1997-310, s. 3.)

CASE NOTES

Assignment Does Not Preclude Increase of Allowance. — The assignment of a year's provision under this section does not serve to preclude the widow's right to an increase thereof under G.S. 30-26 et seq. Mann v. Mann, 173 N.C. 20, 91 S.E. 355 (1917).

§ 30-21. Report of clerk or magistrate.

The clerk of court, or magistrate upon assignment, shall make and sign three lists of the money or other personal property assigned to each person, stating their quantity and value, and the deficiency to be paid by the personal representative. Where the allowance is to the surviving spouse, one of these lists shall be delivered to him. Where the allowance is to a child, one of these lists shall be delivered to the surviving parent with whom the child is living; or to the child's guardian or next friend if the child is not living with said surviving parent; or to the child if said child is not living with the surviving parent and has no guardian or next friend. One list shall be delivered to the personal representative. One list shall be returned by the magistrate or clerk, within 20 days after the assignment, to the superior court of the county in which administration was granted or the will probated, and the clerk shall file and record the same, together with any judgment entered pursuant to G.S. 30-20. (1868-9, c. 93, s. 15; Code, s. 2123; Rev., s. 3099; C.S., s. 4116; 1961, c. 749, s. 7; 1971, c. 528, s. 24; 1989, c. 11, s. 3; 1997-310, s. 3.)

CASE NOTES

Filing of List Mandatory. — The filing and recording of the list of articles (now money or other personal property) allotted to the widow, as her year's support, as required by this section, is essential to its validity, and to the vesting in her of the property or debt allotted to the widow. Kiff v. Kiff, 95 N.C. 71 (1886).

Reasonable Certainty Required. — The allotment to the widow must be made with such reasonable certainty, in regard to the thing allotted, as to indicate what property was intended by the commissioners, otherwise the allotment will be void. Under this principle the item, "labor for 3½ years, $173," was held void. Kiff v. Kiff, 95 N.C. 71 (1886).

§ 30-22: Repealed by Session Laws 1971, c. 528, s. 25.

§ 30-23. Right of appeal.

The personal representative, or the surviving spouse, or child by his guardian or next friend, or any creditor, legatee or heir of the deceased, may appeal from the finding of the magistrate or clerk of court to the superior court of the county, and, within 10 days after the assignment, cite the adverse party to appear before such court on a certain day, not less than five nor exceeding 10 days after the service of the citation. (1868-9, c. 93, s. 16; Code, s. 2124; 1897, c. 442; Rev., s. 3100; C.S., s. 4117; 1961, c. 749, s. 9; 1989, c. 11, s. 4; 1997-310, s. 3.)

CASE NOTES

Findings Supported by Evidence Not Reviewed. — The findings of the judge in the special proceedings for the allotment of the year's support will not be reviewed on appeal where there is evidence to support such findings. Drewry v. Raleigh Sav. Bank & Trust Co., 173 N.C. 664, 92 S.E. 593 (1917).

Timeliness of Appeal. — Devisee under a will did not file an appeal from the trial court's approval of an assignment of a year's allowance to the surviving spouse, and waited more than eight months before filing her motion to set aside the assignment of the year's allowance to the surviving spouse; accordingly, the devisee failed to subsequently appeal within the required time under G.S. 30-23, and a notice requirement was not imposed with respect to the statutory right to the year's allowance for the surviving spouse. In re Estate of Archibald, — N.C. App. —, 644 S.E.2d 264, 2007 N.C. App. LEXIS 1046 (2007).

Applied in In re Godwin, 17 N.C. App. 365, 194 S.E.2d 204 (1973).

Cited in In re Trogdon, 330 N.C. 143, 409 S.E.2d 897 (1991).

§ 30-24. Hearing on appeal.

At or before the day named, the appellant shall file with the clerk a copy of the assignment and a statement of his exceptions thereto, and the issues thereby raised shall be decided de novo. (1868-9, c. 93, s. 17; Code, s. 2125; Rev., s. 3101; C.S., s. 4118; 1989, c. 11, s. 5; 1997-310, s. 3.)

§ 30-25. Personal representative entitled to credit.

Upon the settlement of the accounts of the personal representative, he shall be credited with the articles assigned, and the value of the deficiency assessed as aforesaid, if the same shall have been paid, unless the allowance be impeached for fraud or gross negligence in him. (1868-9, c. 93, s. 18; Code, s. 2126; Rev., s. 3102; C.S., s. 4119; 1997, c. 310, s. 3.)

§ 30-26. When above allowance is in full.

If the estate of a deceased be insolvent, or if his personal estate does not exceed ten thousand dollars ($10,000), the allowances for the year's support of the surviving spouse and the children shall not, in any case, exceed the value prescribed in G.S. 30-15 and G.S. 30-17; and the allowances made to them as above prescribed shall preclude them from any further allowances. (1868-9, c. 93, s. 19; Code, s. 2127; Rev., s. 3103; C.S., s. 4120; 1961, c. 749, s. 10; 1981, c. 413, s. 3; 1995, c. 262, s. 6; 1995 (Reg. Sess., 1996), c. 742, s. 17; 1997-310, s. 3.)

CASE NOTES

Assignment Does Not Bar Increased Allowance. — The assignment of an allowance to a widow under G.S. 30-20 is not a bar to a subsequent petition for an increased allowance. The very language of the statute plainly indicates that the widow may have a further allowance in addition to the first, if the estate exceeds $2,000. Mann v. Mann, 173 N.C. 20, 91 S.E. 355 (1917).

Part 3. Assigned in Superior Court.

§ 30-27. Surviving spouse or child may apply to superior court.

It shall not, however, be obligatory on a surviving spouse or child to have the support assigned as above prescribed. Without application to the personal representative, the surviving spouse, or the child through his guardian or next friend, may at any time within one year after the decedent's death, apply to the superior court of the county in which administration was granted or the will probated to have a year's support assigned. (1868-9, c. 93, s. 20; Code, s. 2128; Rev., s. 3104; C.S., s. 4121; 1961, c. 749, s. 11.)

Legal Periodicals. — For survey of 1978 property law, see 57 N.C.L. Rev. 1103 (1979).

CASE NOTES

Approval of Allowance Less Than Maximum under § 30-31. — Where the superior court found a sum which a widow has agreed to accept to be reasonable and proper, though less than her maximum allowance would have been if calculated under G.S. 30-31, this section gives the court the jurisdiction to make the allowance agreed upon. Wachovia Bank & Trust Co. v. Waddell, 234 N.C. 454, 67 S.E.2d 651 (1951).

Irrelevant Allegations in Answer. — Upon petition for allotment of a widow's year's allowance, allegations in the answer to the effect that the widow did not need an allotment for her support, that deceased's will evidenced a desire that the widow should receive no part of the estate, and that defendants were the aged and infirm parents of deceased dependent upon the estate left them by the will, are irrelevant to the issues and could not be shown in evidence, and were properly stricken upon motion, since even the reading of the pleadings would be highly prejudicial to petitioner. Edwards v. Edwards, 230 N.C. 176, 52 S.E.2d 281 (1949).

Deduction of Year's Allowance from Widow's Distributive Share Proper. — G.S. 30-27 merely outlined an alternative procedural method to pursue larger allowances in superior court and should, in all other ways, have been treated in like manner with allowances administered pursuant to G.S. 30-15; there was no error in a trial court's order charging the year's allowance paid to the decedent's widow against the widow's distributive share. Bryant v. Bowers, — N.C. App. —, 641 S.E.2d 855, 2007 N.C. App. LEXIS 583 (2007).

Cited in Estate of Loftin v. Loftin, 285 N.C. 717, 208 S.E.2d 670 (1974); In re Estate of Kirkman, 38 N.C. App. 515, 248 S.E.2d 438 (1978).

§ 30-28. Nature of proceeding; parties.

The application shall be by summons, as is prescribed for special proceedings, in which the personal representative of the deceased, if there be one other than the plaintiff, the largest known creditor, or legatee, or some distributee of the deceased, living in the county, shall be made defendant, and the proceedings shall be as prescribed for special proceedings between parties. (1868-9, c. 93, s. 21; Code, s. 2129; Rev., s. 3105; C.S., s. 4122.)

§ 30-29. What complaint must show.

In the complaint the plaintiff shall set forth, besides the facts entitling plaintiff to a year's support and the value of the support claimed, the further facts that the estate of the decedent is not insolvent, and that the personal estate of which he died possessed exceeded ten thousand dollars ($10,000), and also whether or not an allowance has been made to plaintiff and the nature and value thereof. (1868-9, c. 93, s. 22; Code, s. 2130; Rev., s. 3106; C.S., s. 4123; 1961, c. 749, s. 12; 1981, c. 413, s. 4; 1995, c. 262, s. 7.)

§ 30-30. Judgment and order for commissioners.

If the material allegations of the complaint be found true, the judgment shall be that plaintiff is entitled to the relief sought; and the court shall thereupon issue an order to the sheriff or other proper officer of the county, commanding him to summon a magistrate and two persons qualified to act as jurors, who shall determine the money or other personal property of the estate and assign to the plaintiff a sufficiency thereof for plaintiff's support for one year from the decedent's death. Any deficiency shall be made up from any of the personal property of the deceased, and if the personal property of the estate shall be insufficient for such support, the clerk of the superior court shall enter judgment against the personal representative for the amount of such deficiency, to be paid when a sufficiency of such assets shall come into his hands. (1868-9, c. 93, s. 23; Code, s. 2131; Rev., s. 3107; C.S., s. 4124; 1961, c. 749, s. 13; 1971, c. 528, s. 26.)

§ 30-31. Duty of commissioners; amount of allowance.

The said commissioners shall be sworn by the magistrate and shall proceed as prescribed in this Chapter, except that they may assign to the plaintiff a value sufficient for the support of plaintiff according to the estate and condition of the decedent and without regard to the limitations set forth in this Chapter; but the value allowed shall be fixed with due consideration for other persons entitled to allowances for year's support from the decedent's estate; and the total value of all allowances shall not in any case exceed the one half of the average annual net income of the deceased for three years next preceding his death. This report shall be returned by the magistrate to the court. (1868-9, c. 93, s. 24; Code, s. 2132; Rev., s. 3108; C.S., s. 4125; 1971, c. 528, s. 27.)

Legal Periodicals. — For survey of 1978 property law, see 57 N.C.L. Rev. 1103 (1979).

CASE NOTES

Meaning of Annual Net Income. — The provision of this section that the allowance shall not exceed "the one half of the [average] annual net income of the deceased for three years next preceding his death" means the one half of one year's net income, determined by the average annual income for the three years next preceding the decease, and not one half of the sum total of the annual net income for the three-year period. Holland v. Henson, 189 N.C. 742, 128 S.E. 145 (1925).

"Net income" in this section is not "adjusted gross income," but rather is to be computed after deducting all federal and state income taxes attributable to the income received by the decedent during the three years preceding his death. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

Net income in this section means "take home pay" or "after-tax income," because this is the only income that is "netted," that is truly available for family support purposes in a real sense, as any employee whose earnings are subject to withholding can testify. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

Sufficient Allowance to Maintain Standard of Living. — This section is designed to permit the allowance to the surviving spouse of a solvent decedent of an amount sufficient to maintain for a period that standard of living to which he or she had been accustomed, thereby avoiding the hardship which an immediate and drastic reduction in income would entail. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

The purpose of the larger allowance authorized by this Part appears to be to provide the surviving spouse of a solvent decedent with a level of support commensurate with the support which he or she would have had from the deceased spouse during the first year after the spouse's death had the death not occurred. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

The legislature by this section intended the widow to receive an allotment not exceeding one half of the income which would probably have been actually received by and available to her deceased husband for the support of his family, had he lived an additional year. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

Allowance May Be Less Than Prescribed Maximum. — The formula in this section serves only to calculate the maximum allowance which may be assigned and does not represent an amount which must be assigned. The only requirement laid down by this section is that the allowance be, within the maximum limit specified, "a value sufficient for the support of plaintiff according to the estate and condition of the decedent." In some cases, this amount could be considerably less than the statutorily prescribed maximum. Pritchard v. First-Citizens Bank & Trust Co., 38 N.C. App. 489, 248 S.E.2d 467 (1978).

Approval of Allowance Less Than Maximum. — Where the superior court found a sum which a widow has agreed to accept to be reasonable and proper, though less than her maximum allowance would have been if calculated under this section, G.S. 30-27 gives the court the jurisdiction to make the allowance agreed upon. Wachovia Bank & Trust Co. v. Waddell, 234 N.C. 454, 67 S.E.2d 651 (1951).

Allowance Sustained Where Discretion Not Abused. — Where the estate of the deceased husband is large and in good condition, and he received a net annual income for three years prior to his death of over $38,500, an allowance of $12,500 for a year's support to his widow with minor son, less the value of the household furniture, is not an abuse of the superior court's discretion which the Supreme Court will review. Drewry v. Raleigh Sav. Bank & Trust Co., 173 N.C. 664, 92 S.E. 593 (1917).

§ 30-32. Exceptions to the report.

The personal representative, or any creditor, distributee or legatee of the deceased, within 10 days after the return of the report, may file exceptions thereto. The plaintiff shall be notified thereof and cited to appear before the court on a certain day, within 20 and not less than 10 days after service of the notice, and answer the same; the case shall thereafter be proceeded in, heard and decided as provided in special proceedings between parties. (1868-9, c. 93, s. 25; Code, s. 2133; Rev., s. 3109; C.S., s. 4126; 1947, c. 484, s. 1.)

§ 30-33. Confirmation of report; execution.

If the report shall be confirmed, the court shall so declare, and execution shall issue to enforce the judgment as in like cases. (1868-9, c. 93, s. 26; Code, s. 2134; Rev., s. 3110; C.S., s. 4127.)

Chapter 31.

Wills.

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31-41. Will relates to death of testator.
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31-42.1, 31-42.2. [Repealed.]
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31-46. Validity of will; which laws govern.

Article 8.

Testamentary Additions to Trusts.

31-47. Testamentary additions to trusts.

Article 9.

Incorporation by Reference; Acts of Independent Significance.

31-51. Incorporation by reference.
31-52. Acts and events of independent significance.

ARTICLE 1.

Execution of Will.

§ 31-1. Who may make will.

Any person of sound mind, and 18 years of age or over, may make a will. (1811, c. 280; R.C., c. 119, s. 2; Code, s. 2137; Rev., s. 3111; C.S., s. 4128; 1953, c. 1098, s. 1; 1965, c. 303; 1969, c. 39.)

Legal Periodicals. — For article on drafting and probate of wills, see 23 N.C.L. Rev. 306 (1945).

For comment on the 1953 amendments to this Chapter, see 31 N.C.L. Rev. 444 (1953).

For article on medication as a threat to testamentary capacity, see 35 N.C.L. Rev. 380 (1957).

For case law survey on wills and administration, see 41 N.C.L. Rev. 530 (1963).

For article, "The Contracts of Minors Viewed from the Perspective of Fair Exchange," see 50 N.C.L. Rev. 517 (1972).

For note as to the transfer of land by wills in light of Stephenson v. Rowe, 315 N.C. 330, 338 S.E.2d 301 (1986), see 65 N.C.L. Rev. 1488 (1987).

For article, "Abolishing the Attestation Requirement for Wills," see 68 N.C.L. Rev. 541 (1990).

For comment on the standard of mental capacity in North Carolina for legal transactions of the elderly, see 32 Wake Forest L. Rev. 563 (1997).

CASE NOTES

Law in this State presumes that every person has sufficient mental capacity to make a valid will, and those persons contesting the will have the burden of proving that the testator lacked the required mental capacity. In re Will of Womack, 53 N.C. App. 221, 280 S.E.2d 494, cert. denied, 304 N.C. 391, 285 S.E.2d 837 (1981).

What Constitutes Sufficient Mental Capacity. — A person has sufficient testamentary capacity within the meaning of the law if he comprehends the natural objects of his bounty, understands the kind, nature, and extent of his property, knows the manner in which he desires his act to take effect, and realizes the effect his act will have upon his estate. In re Will of Womack, 53 N.C. App. 221, 280 S.E.2d 494, cert. denied, 304 N.C. 391, 285 S.E.2d 837 (1981).

Burden of Proving Lack of Mental Capacity. — Wherever one alleges that the maker of a will did not have sufficient mental capacity to make it, then the burden is upon such person to satisfy the jury by the greater weight of the evidence of the truth of his contention and to overcome the presumption of sanity after the formal execution has been established. In re Pridgen's Will, 249 N.C. 509, 107 S.E.2d 160 (1959).

Mere ignorance of a technical statute relating to wills does not evidence a lack of testamentary capacity. In re Will of Farr, 277 N.C. 86, 175 S.E.2d 578 (1970).

Instruction as to Mental Capacity. — When the court in its charge stated the rule to measure mental capacity in this language: "It is your duty in passing on the mental capacity of M.W. Pridgen to determine with reference to the will in controversy whether when he signed same he had such mental capacity as enabled him to understand the provisions contained in the paper, the extent of the same, and to know that he was giving the property therein bequeathed or devised to the person named therein and that he desired her to have it as written in the paper, to know his relatives and to know and realize that it was his free will and desire that his relatives should not have any property of his other than in the manner devised, or that devised," it was in substance if not verbatim the rule as stated in numerous decisions by the Supreme Court. In re Pridgen's Will, 249 N.C. 509, 107 S.E.2d 160 (1959).

Insane delusion must be distinguished from prejudice, hate, bad judgment, ill will, and any number of other conditions which might be associated with sanity. To be sufficient to invalidate the will, the delusion must have no foundation in fact and must be the product of the testator's diseased or deranged mind. However, to justify the setting aside of a will on the ground that the testatrix was possessed of an insane delusion, it must also be shown that the insane delusion was actually operative in the production of the will. In re Will of Maynard, 64 N.C. App. 211, 307 S.E.2d 416 (1983).

Partial Insanity and Insane Delusion Invalidate Will. — Generally, partial insanity will invalidate a will which is the direct offspring thereof, and a will which is the product of an insane delusion is also invalid for want of testamentary capacity. In re Will of Maynard, 64 N.C. App. 211, 307 S.E.2d 416 (1983).

Insane Delusion as to One of Essentials of Testamentary Capacity. — If a person has sufficient mental ability to make a will but is subject to an insane delusion, i.e., monomania, as to one of the essential requirements of testamentary capacity, the will would not be valid. For example, if the testator has an insane delusion as to the objects of his bounty, it would invalidate his will. In re Will of Maynard, 64 N.C. App. 211, 307 S.E.2d 416 (1983).

Primary object in interpreting a will is to give effect to the intention of the testator. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Presumption Against Intestacy. — It is a long-standing policy of the State of North Carolina to construe a will with the presumption that the testator did not intend to die intestate with respect to any part of his property. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Under earlier prior law it was held that an infant between 21 and 18 could dispose of personal estate by will. Williams' Legatees v. Heirs at Law, 44 N.C. 271 (1853).

As to will executed in another state under prior law, see in In re Reynolds, 206 N.C. 276, 173 S.E. 789 (1934).

Applied in Holloway v. Wachovia Bank & Trust Co., 104 N.C. App. 631, 410 S.E.2d 915 (1991).

Cited in McCraw v. Llewellyn, 256 N.C. 213, 123 S.E.2d 575 (1962).

§ 31-2: Repealed by Session Laws 1953, c. 1098, s. 1.

§ 31-3: Rewritten and renumbered as G.S. 31-3.1 to 31-3.6 by Session Laws 1953, c. 1098, s. 2.

§ 31-3.1. Will invalid unless statutory requirements complied with.

No will is valid unless it complies with the requirements prescribed therefor by this Article. (1953, c. 1098, s. 2.)

Legal Periodicals. — For article on what is sufficient subscription, what are valuable papers, what is meant by depositing with someone for safekeeping, and animus testandi, see 2 N.C.L. Rev. 107 (1924).

CASE NOTES

Editor's Note. — *Some of the cases cited below construe former G.S. 31-3.*

Instrument Executed Without Proper Formalities Is Void. — An instrument which is testamentary in effect but does not follow the prescribed formalities for the proper execution of a will is void. Baxter v. Jones, 14 N.C. App. 296, 188 S.E.2d 622, cert. denied, 281 N.C. 621, 190 S.E.2d 465 (1972).

Compliance with Statutory Requirements. — See Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956). See also Little v. Lockman, 49 N.C. 494 (1857); Peace v. Edwards, 170 N.C. 64, 86 S.E. 807 (1915); Wescott v. First & Citizens Nat'l Bank, 227 N.C. 39, 40 S.E.2d 461 (1946); In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948).

Necessity of Animus Testandi. — The distinguishing feature of all genuine testamentary instruments, whatever their form, is that the paper-writing must appear to be written animus testandi. It is essential that it should appear from the character of the instrument, and the circumstances under which it is made, that the testator intended it should operate as his will, or as a codicil to it. In re Perry, 193 N.C. 397, 137 S.E. 145 (1927).

For a memorandum written and signed by the testator to take effect as his will, it must, among other requisites, show that it was made animus testandi, and where the other formalities have been observed, a "pack" of letters containing a note in his favor, with the indorsement written thereon, and signed by him, a long time prior to his death, "I want S.W. have this pack," will not operate either as a valid holograph will or codicil. In re Perry, 193 N.C. 397, 137 S.E. 145 (1927).

Where the animus testandi appears as doubtful the question is for the jury. In re Will of Harrison, 183 N.C. 457, 111 S.E. 867 (1922).

Otherwise Where Animus Testandi Conclusively Presumed. — Where propounders introduce ample evidence that the paper-writing was in the handwriting of deceased and there is no evidence to the contrary, and the paper-writing is dispositive on its face and unequivocally shows the intention of deceased that it should operate as his will, the animus testandi is conclusively presumed, and it is error for the court to submit the question of such intention to the jury over the objection of propounders. In re Rowland's Will, 206 N.C. 456, 174 S.E. 284 (1934).

Codicil to a Will. — In North Carolina, a codicil to a will must be executed with the same formalities as the will. Consequently, a testamentary instrument that fails to follow the prescribed formalities is void. Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991).

Writing Drafted from Dictations after Testator's Death. — A paper-writing drafted by an attorney from a stenographer's notes taken from dictation of deceased as to the disposition of her property after death, unsigned and unwitnessed, is not admissible as a last will and testament. Kennedy v. Douglas, 151 N.C. 336, 66 S.E. 216 (1909).

An agreement to adopt a minor and make her his heir, made between the person desiring to adopt the minor and the minor's parents, as the respective parties to the agreement, indicates that the instrument is not intended as a will. Chambers v. Byers, 214 N.C. 373, 199 S.E. 398 (1938).

As to devisability of possibility of reverter before condition broken, see Church v. Young, 130 N.C. 8, 40 S.E. 691 (1902).

Question of Fact on Testamentary Formalities Precluded Summary Judgment. — Material issue of fact existed regarding whether a testator complied with the will formalities required by G.S. 31-3.3 where the evidence tended to show that the testator did not sign the will in the presence of one of the witnesses; that evidence raised material questions of fact on whether the will complied with the testamentary formalities of G.S. 31-1 and G.S. 31-3.3, so summary judgment in favor of the propounder of the will was improper. In re Will of Priddy, 171 N.C. App. 395, 614 S.E.2d 454, 2005 N.C. App. LEXIS 1213 (2005).

§ 31-3.2. Kinds of wills.

(a) Personal property may be bequeathed and real property may be devised by

(1) An attested written will which complies with the requirements of G.S. 31-3.3, or

(2) A holographic will which complies with the requirements of G.S. 31-3.4.

(b) Personal property may also be bequeathed by a nuncupative will which complies with the requirements of G.S. 31-3.5. (1953, c. 1098, s. 2.)

§ 31-3.3. Attested written will.

(a) An attested written will is a written will signed by the testator and attested by at least two competent witnesses as provided by this section.

(b) The testator must, with intent to sign the will, do so by signing the will himself or by having someone else in the testator's presence and at his direction sign the testator's name thereon.

(c) The testator must signify to the attesting witnesses that the instrument is his instrument by signing it in their presence or by acknowledging to them his signature previously affixed thereto, either of which may be done before the attesting witnesses separately.

(d) The attesting witnesses must sign the will in the presence of the testator but need not sign in the presence of each other. (1953, c. 1098, s. 2.)

Cross References. — As to witnesses to will, see G.S. 31-8.1 through 31-10. As to manner of probate of attested written will, see G.S. 31-18.1.

Legal Periodicals. — For comment on the necessity for proof of due execution of a will, see 3 Wake Forest Intra. L. Rev. 12 (1967).

CASE NOTES

I. General Consideration.
II. Signing by or for Testator.
III. Attestation by Witnesses.

I. GENERAL CONSIDERATION.

Editor's Note. *— Some of the cases cited below construe former G.S. 31-3.*

For a will to be admitted to probate, G.S. 31-18.1(a)(1) requires that the will meet the requirements of this section and that two of the attesting witnesses testify before the court. In re Will of Everhart, 88 N.C. App. 572, 364 S.E.2d 173, cert. denied, 322 N.C. 112, 367 S.E.2d 910 (1988).

In order to prove formal execution of a will by subscribing witnesses, as required by this section, it must appear that the will was signed by the testator or some other person in his presence and by his direction, and subscribed in his presence by at least two witnesses and when the testator does not sign the will in the presence of the witnesses, the signature should be acknowledged by him. In re Will of Franks, 231 N.C. 252, 56 S.E.2d 668 (1949). See In re Morrow's Will, 234 N.C. 365, 67 S.E.2d 279 (1951).

In order to be a valid written will with witnesses, the same should be signed by the testator or some other person in his presence and by his direction, or the signature should be acknowledged by the testator, and subscribed in his presence by at least two witnesses. Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913).

A codicil must be executed with the same formality as the will. Paul v. Davenport, 217 N.C. 154, 7 S.E.2d 352 (1940); In re Will of King, 80 N.C. App. 471, 342 S.E.2d 394, cert. denied, 317 N.C. 704, 347 S.E.2d 43 (1986).

Testimony Showing Formal Execution of Will. — Testimony of one subscribing witness to the effect that he signed the instrument at the request of testator simultaneously with the testator, and testimony of the other that when he signed same it had already been signed by testator, together with testimony that testator stated to the witnesses that the instrument was his will and requested them to sign same, was held sufficient to show formal execution of the will and to support the charge of the court hereon. In re Will of Franks, 231 N.C. 252, 56 S.E.2d 668 (1949).

Conformance with Statutory Requirements Is Prima Facie Proof. — In a caveat proceeding, proof of the formal execution of an attested will in conformity with the statutory requirements establishes prima facie that the offered document is the will of the testator and is sufficient to allow the jury to find that the document is the will of the testator. In re Will of Cooley, 66 N.C. App. 411, 311 S.E.2d 613 (1984).

Order of Signing and Attestation. — Some authorities hold that everything required to be done by the testator in the execution of a will shall precede in point of time the subscription by the attesting witness, and that if the signature of the latter precede the signing by the testator the will is void. Until the testator has signed, there is no will and nothing to attest. There are eminent authorities, however, which hold that where the signing of the testator and of the witnesses took place at the same time and constituted one transaction, it is immaterial who signed first. In re Baldwin, 146 N.C. 25, 59 S.E. 163 (1907).

Distinction Between Signing and Subscribing. — The authorities make a distinction between statutes requiring instruments to be signed and those requiring them to be subscribed, holding with practical unanimity in reference to the first class, that it is not necessary for the name to appear on any particular part of the instrument, if written with the intent to become bound; and, as to the second class, that the name must be at the end of the instrument. Peace v. Edwards, 170 N.C. 64, 86 S.E. 807 (1915); In re Williams' Will, 234 N.C. 228, 66 S.E.2d 902 (1951), commented on in 30 N.C.L. Rev. 201 (1952).

Undated Will. — The testator's signature to the will is required though it is not required that the paper-writing be subscribed or dated. Therefore an undated will, when the name of the testator, in his own handwriting, appears in the body thereof, has the same legal effect as those bearing dates and subscribed by the testator. Peace v. Edwards, 170 N.C. 64, 86 S.E. 807 (1915).

Where Only One of Inconsistent Wills Dated. — Where the decedent has left several paper-writings purporting to be his last will, containing the opening declaration, as to each, that the testator made the same as his "last will and testament," but only one of them bears date and his name subscribed thereto, and each of them making a disposition of his property different from the other, the undated and unsubscribed wills have the same legal effect as the one dated and subscribed, though the testator had indorsed under his signature, thereon, the words "last will"; and in the absence of proof as to which of the wills was the last one, the legal effect is intestacy. Peace v. Edwards, 170 N.C. 64, 86 S.E. 807 (1915), construing former § 31-3.

Applied in In re Crawford's Will, 246 N.C. 322, 98 S.E.2d 29 (1957); In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Cited in In re Covington's Will, 252 N.C. 546, 114 S.E.2d 257 (1960); In re Will of Gilkey, 256 N.C. 415, 124 S.E.2d 155 (1962); In re Will of Cobb, 271 N.C. 307, 156 S.E.2d 285 (1967); In re Will of Hodgin, 10 N.C. App. 492, 179 S.E.2d 126 (1971); In re Will of Weston, 38 N.C. App. 564, 248 S.E.2d 359 (1978); Brickhouse v. Brickhouse, 104 N.C. App. 69, 407 S.E.2d 607 (1991); In re Will of Jarvis, 107 N.C. App. 34, 418 S.E.2d 520 (1992); In re Will of McCauley, 356 N.C. 91, 565 S.E.2d 88, 2002 N.C. LEXIS 550 (2002); In re Campbell, 155 N.C. App. 441, 573 S.E.2d 550, 2002 N.C. App. LEXIS 1639 (2002), cert. denied, 357 N.C. 63, 579 S.E.2d 385 (2003).

II. SIGNING BY OR FOR TESTATOR.

Signing in Presence of Witnesses Not Necessary. — It is not necessary that testator sign his will in the presence of the attesting witnesses, but if he does not do so he must acknowledge his signature either by acts or conduct. In re Will of Franks, 231 N.C. 252, 56 S.E.2d 668 (1949).

It is not required that testator sign the will in the presence of the attesting witnesses. In re Will of Etheridge, 229 N.C. 280, 49 S.E.2d 480 (1948).

This section does not require the testator to manually sign his will in the presence of the subscribing witnesses, and the validity of the written instrument in this respect will be upheld if the testator produces the will itself, and acknowledges and identifies it and his signature thereto, at the time the witnesses subscribe their names as such. Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913); In re Fuller's Will, 189 N.C. 509, 127 S.E. 549 (1925).

Name of Testator May Be Signed by Another. — That the name of the testator may be signed to the paper-writing by some other person in his presence and by his direction is expressly authorized by the statute. In re Williams' Will, 234 N.C. 228, 66 S.E.2d 902 (1951), commented on in 30 N.C.L. Rev. 201 (1952).

Signature Made for Testatrix in Her Presence. — An instruction that it was not required that the will should be manually signed by the alleged testatrix if her name was signed thereto by someone in her presence, by her direction, or if such a signature was acknowledged by her as her signature to the instrument presented as her last will, was held correct. In re Will of Johnson, 182 N.C. 522, 109 S.E. 373 (1921).

Assistance to Physically Weak Testator. — Where the testator signified by a nod of his head that the paper writing read to him was his will, and although the testator was severely physically incapacitated, he was mentally alert and able to make known any objection he might have had to the minister signing his name to the will, and this he failed to do; indeed, he placed his hand upon the pen while the minister made his mark, this evidence gives rise to an inference to be resolved by the jury as to whether the will was duly executed according to law. In re Will of Knowles, 11 N.C. App. 155, 180 S.E.2d 394 (1971).

Assistance by Attorney. — Attorney's assisting testator to form his mark and signing testator's name legibly beside each mark did not disqualify him as a witness. In re Will of Jarvis, 334 N.C. 140, 430 S.E.2d 922 (1993).

Evidence that testator made his mark on codicil in the presence of the witnesses indicates that the instrument was his, and is sufficient to imply a request that they attest his signature. In re Will of King, 80 N.C. App. 471, 342 S.E.2d 394, cert. denied, 317 N.C. 704, 347 S.E.2d 43 (1986).

The North Carolina statutes have never required a testator to subscribe his signature to his will. Yount v. Yount, 258 N.C. 236, 128 S.E.2d 613 (1962).

Where a will is written on two or more separate sheets, the statute does not require that they be physically attached or that the signature of the testator appear on each sheet. It is sufficient if the signature of the testator appears in any part of the will. In re Roberts' Will, 251 N.C. 708, 112 S.E.2d 505 (1960); In re Sessoms' Will, 254 N.C. 369, 119 S.E.2d 193 (1961).

III. ATTESTATION BY WITNESSES.

Attestation in Presence of Testator Is Essential. — It is essential that the will be subscribed in the presence of the testator by at least two witnesses. In re Thomas, 111 N.C. 409, 16 S.E. 226 (1892).

Material issue of fact existed regarding whether a testator complied with the will formalities required by G.S. 31-3.3 where the evidence tended to show that the testator did not sign the will in the presence of one of the witnesses; that evidence raised material questions of fact on whether the will complied with the testamentary formalities of G.S. 31-1 and G.S. 31-3.3, so summary judgment in favor of the propounder of the will was improper. In re Will of Priddy, 171 N.C. App. 395, 614 S.E.2d 454, 2005 N.C. App. LEXIS 1213 (2005).

If the subscribing witnesses signed a will in a room adjacent to the room in which testator was lying in bed, but the testator was in a position where he did see or could have seen them subscribe their names, the attestation was in compliance with law. In re Pridgen's Will, 249 N.C. 509, 107 S.E.2d 160 (1959).

Witnesses Need Not Sign in Presence of Each Other. — See In re Will of Franks, 231 N.C. 252, 56 S.E.2d 668 (1949). See also Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913); In re Will of Johnson, 182 N.C. 522, 109 S.E. 373 (1921).

Witnesses are not required to sign in the presence of each other; only in the presence of the testator. In re Long's Will, 257 N.C. 598, 126 S.E.2d 313 (1962).

Where the judge told the jury that if the signatures of the witnesses "were subscribed thereto at the request of the testator and in his presence and in the presence of each other" they would answer the issue of execution of the will "Yes," this was error, and a new trial was required even though all the evidence tended to show that the witnesses did sign in the presence of each other. In re Long's Will, 257 N.C. 598, 126 S.E.2d 313 (1962).

Where witness who signed the will in a location different from the other two witnesses testified and stated in her affidavit that she was a witness to the testator's mark at the request of the testator, who declared the document to be his will, the trial court did not err in finding that witness was an attesting witness. Brickhouse v. Brickhouse, 110 N.C. App. 560, 430 S.E.2d 446 (1993).

The attestation by witnesses must be on the sheet of paper containing the testator's signature, or else upon some paper physically connected with that sheet. In re Baldwin, 146 N.C. 25, 59 S.E. 163 (1907).

Signing of Copy. — When a witness who had properly signed as such, no other witness signing, had the will copied upon different paper in the absence of the testator, signed the copy, left it at the home of the testator with the original, who afterwards procured the due attestation and signature of the other witness on the copy, both of which were found among the papers of the testator after his death, but the original was destroyed, the copy is not valid as a will, and evidence that the first draft was identical with the copy is incompetent, the first witness having signed before the testator, and not in his presence, there being no physical connection between the original and copy, and not upon the same paper as that of the signature of the testator. In re Baldwin, 146 N.C. 25, 59 S.E. 163 (1907).

Whether Attestation Impliedly Requested Is Question for Jury. — It is for the jury to determine whether the testatrix impliedly requested the attesting witnesses to attest the will, an implied request being sufficient to submit the question to the jury. In re Kelly's Will, 206 N.C. 551, 174 S.E. 453 (1934).

Attestation Sufficient Despite Wavering in Testimony. — Evidence tending to show that one of the subscribing witnesses signed the will as such in the presence of testatrix and the other subscribing witness warrants the jury in finding that the witness' subscription met the requirements of this section, notwithstanding that the witness wavered somewhat in her testimony. In re Redding's Will, 216 N.C. 497, 5 S.E.2d 544 (1939).

Instrument Held Not Validly Witnessed. — Where a witness subscribes his name to an instrument during the afternoon, and the purported testatrix signs the instrument the following night, but not in the presence of the witness, the signing of the instrument by the parties cannot be construed as one and the same transaction, and the instrument is not validly witnessed and attested by him, and, upon proof that the instrument was properly subscribed by one other witness, a peremptory instruction in favor of caveators is without error for want of proof that the instrument was subscribed by two witnesses. In re McDonald's Will, 219 N.C. 209, 13 S.E.2d 239 (1941).

§ 31-3.4. Holographic will.

(a) A holographic will is a will

(1) Written entirely in the handwriting of the testator but when all the words appearing on a paper in the handwriting of the testator are sufficient to constitute a valid holographic will, the fact that other words or printed matter appear thereon not in the handwriting of the testator, and not affecting the meaning of the words in such handwriting, shall not affect the validity of the will, and

(2) Subscribed by the testator, or with his name written in or on the will in his own handwriting, and

(3) Found after the testator's death among his valuable papers or effects, or in a safe-deposit box or other safe place where it was deposited by him or under his authority, or in the possession or custody of some person with whom, or some firm or corporation with which, it was deposited by him or under his authority for safekeeping.

(b) No attesting witness to a holographic will is required. (1953, c. 1098, s. 2; 1955, c. 73, s. 1.)

Cross References. — As to manner of probate of holographic will, see G.S. 31-18.2.

Legal Periodicals. — For case law survey on holographic wills, see 41 N.C.L. Rev. 535 (1963).

For brief comment on the 1955 amendment, see 33 N.C.L. Rev. 597 (1955).

For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

CASE NOTES

I. General Consideration.
II. Testamentary Intent.
III. Signature.
IV. Found Among Valuable Papers, etc.

I. GENERAL CONSIDERATION.

Editor's Note. — *Many of the cases cited below construe former G.S. 31-3.*

Legislative History of Section. — See In re Will of Gilkey, 256 N.C. 415, 124 S.E.2d 155 (1962).

It is not required that a holographic will be dated or the place of its execution stated therein. Pounds v. Litaker, 235 N.C. 746, 71 S.E.2d 39 (1952).

A paper-writing in the handwriting of testatrix, duly proven by three credible witnesses, signed by testatrix and found among her valuable papers after her death, which paper-writing contains dispositive words sufficient to dispose of the estate, is valid as a holograph will under this section and G.S. 31-18.2, and it is not necessary that the writing be dated or show the place of execution. In re Parson's Will, 207 N.C. 584, 178 S.E. 78 (1935), citing In re Will of Lowrance, 199 N.C. 782, 155 S.E. 876 (1930).

Words Not in Handwriting of Testator. — Every word of a holographic will must be in the handwriting of testator, and while words printed on the paper will not invalidate the instrument but will be treated as surplusage if such printed words are not essential to the written words, printed words or letters may not be used to supply any essential part of the instrument. Pounds v. Litaker, 235 N.C. 746, 71 S.E.2d 39 (1952).

When all the words appearing on a paper in the handwriting of the deceased person are sufficient to constitute a last will and testament, the mere fact that other words appear thereon, not in such handwriting, but not essential to the meaning of the words in such handwriting, cannot be held to defeat the intention of the deceased, otherwise clearly expressed, that such paper-writing is and shall be her last will and testament. In re Will of Lowrance, 199 N.C. 782, 155 S.E. 876 (1930); In re Parson's Will, 207 N.C. 584, 178 S.E. 78 (1935), wherein the unessential words had been printed on the paper before the testator used it.

Attestation Does Not Invalidate Holographic Will. — The fact of there being a signature of one subscribing witness to a will of land does not prevent it from being proved as a holographic will; and it is no objection to the probate of a script as a holograph will that it has one subscribing witness, and was intended by the decedent to be proved by subscribing witnesses, which intent was frustrated by the fact that the second attesting witness was incompetent. Hill v. Bell, 61 N.C. 122 (1867).

Note Held to Be Codicil. — A note payable to the deceased, found with his holographic will in a box with his other valuable papers after his death, and endorsed thereon in the handwriting of the deceased and over his signature to his wife to take effect after his death, when proved as G.S. 31-18.2 requires, is to be construed as a codicil to his will, and it is not necessary to such construction that it be physically attached to the holographic will. In re Will of Thompson, 196 N.C. 271, 145 S.E. 393 (1928).

Margin Notes. — Additional words found on a holographic will, which were written in a different pen, were not sufficient to entitle caveators challenging the will to a directed verdict, and the jury was allowed to determine the will's authorship. In re Allen, 148 N.C. App. 526, 559 S.E.2d 556, 2002 N.C. App. LEXIS 33 (2002).

Letter as Will. — A letter written by the deceased to his brother, signed by him "Brother Alex," just before the deceased had gone to a hospital for treatment, saying "Brother Richard, take good care of yourself and stay with William at the store. I am going to the hospital on account of not feeling well. I hope God nothing happens, but if it does, everything is yours. Got some money in the bank, but don't know how much we owe on house ... I hope in a few days I will come back," etc., indicates the writer's present intention to dispose of his property, and is provable as his holograph will. Wise v. Short, 181 N.C. 320, 107 S.E. 134 (1921).

Letters written by a member of armed forces which are not offered or proven in the manner or form prescribed are ineffectual as a testamentary disposition of property. Wescott v. First & Citizens Nat'l Bank, 227 N.C. 39, 40 S.E.2d 461 (1946).

In Alston v. Davis, 118 N.C. 202, 24 S.E. 15 (1896), a brother in Texas wrote to his sister in North Carolina that if he got sick or died in Texas he wanted her to have his farm. He simply mailed her the letter. Subsequently he died in Texas and his sister undertook to probate the letter as a holographic will in this State. The question arose whether it had been deposited "with someone for safekeeping"; the court held that this constituted depositing with someone for safekeeping and that the will should be probated. In view of the fact that a testamentary disposition must be accompanied with animus testandi, the decision seems to be clearly unsound, inasmuch as the letter in question discloses no such intention. This conclusion is supported by later decisions of the court which in express terms refuses to follow the doctrine of Alston v. Davis. See Spencer v. Spencer, 163 N.C. 83, 79 S.E. 291 (1913).

It is believed that if the writer of the letter indicates clearly that by mailing it to the addressee he intends to deposit it as a will, the letter would be admitted to probate as such. See In re Ledford's Will, 176 N.C. 610, 12 N.C.L. Rev. 199, 97 S.E. 482, 97 S.E. 482 (1918).

Applied in as to former G.S. 31-3, in In re Gatling's Will, 234 N.C. 561, 68 S.E.2d 301 (1951); In re Bartlett's Will, 235 N.C. 489, 70 S.E.2d 482 (1952); In re Crawford's Will, 246 N.C. 322, 98 S.E.2d 29 (1957).

Cited in In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970); In re Will of Lamparter, 348 N.C. 45, 497 S.E.2d 692 (1998).

II. TESTAMENTARY INTENT.

Evidence of Testamentary Intent Is Necessary. — Before any instrument can be probated as a testamentary disposition there must be evidence that it was written animo testandi, or with testamentary intent. In re Will of Mucci, 287 N.C. 26, 213 S.E.2d 207 (1975).

An instrument may not be probated as a testamentary disposition unless there is evidence that it was written with testamentary intent, that is, that the maker intended that the paper itself should operate as a will or codicil to take effect upon his death. Stephens v. McPherson, 88 N.C. App. 251, 362 S.E.2d 826 (1987).

The maker must intend at the time of making that the paper itself operate as a will, or codicil; an intent to make some foreign testamentary disposition is not sufficient. In re Will of Mucci, 287 N.C. 26, 213 S.E.2d 207 (1975).

Or Instrument May Not Be Admitted to Probate. — If there is nothing on the face of the holograph from which a testamentary intent may be inferred or evidence is lacking that the instrument was found among the deceased's valuable papers or placed by him in the possession of some other person for safekeeping, the instrument may not, as a matter of law, be admitted to probate. In re Will of Mucci, 287 N.C. 26, 213 S.E.2d 207 (1975).

Where Testamentary Intent Must Appear. — With regard to holographic instruments, the necessary animo testandi must appear not only from the instrument itself and the circumstances under which it was made, but also from the fact that the instrument was found among the deceased's valuable papers after his death or in the possession of some person with whom the deceased had deposited it for safekeeping. In re Will of Mucci, 287 N.C. 26, 213 S.E.2d 207 (1975); Stephens v. McPherson, 88 N.C. App. 251, 362 S.E.2d 826 (1987).

When Intent Issue Is for Jury. — Where a holographic instrument on its face is equivocal on the question of whether it was written with testamentary intent and there is evidence that the instrument was found among the valuable papers of the deceased the animo testandi issue is for the jury and parol evidence relevant to the issue may be properly admitted. In re Will of Mucci, 287 N.C. 26, 213 S.E.2d 207 (1975).

III. SIGNATURE.

It is necessary that the testator's name be inserted in his own handwriting in some part of the instrument. Pounds v. Litaker, 235 N.C. 746, 71 S.E.2d 39 (1952).

Name in Body of Will Sufficient Signature. — It is well settled that if the name of the testator appears in his handwriting in the body of the will this is a signing within the meaning of the statute. Hall v. Misenheimer, 137 N.C. 183, 49 S.E. 104, 107 Am. St. R. 474 (1904); Richards v. W.M. Ritter Lumber Co., 158 N.C. 54, 73 S.E. 485 (1911), modified on rehearing, 159 N.C. 455, 74 S.E. 1016 (1912); Boger v. Cedar Cove Lumber Co., 165 N.C. 557, 81 S.E. 784, 1917D Ann. Cas. 116 (1914); Burriss v. Starr, 165 N.C. 657, 81 S.E. 929, 1914D Ann. Cas. 71 (1914); Peace v. Edwards, 170 N.C. 64, 86 S.E. 807 (1915).

Under this section, a paper-writing in the testator's handwriting, dispositive on its face, with the name of the testator inserted therein his own handwriting followed by the words "this being my will" is sufficient in form to constitute a holographic will. In re Rowland, 202 N.C. 373, 162 S.E. 897 (1932).

Engraved Monogram of Testatrix Not Construed as Signature. — An engraved monogram of a testatrix, appearing on the instrument offered for probate in solemn form as a holographic will, may not be considered as a part thereof. The monogram is not in her handwriting and may not be construed to be her signature. Pounds v. Litaker, 235 N.C. 746, 71 S.E.2d 39 (1952).

Signature Need Not Be Witnessed. — It is not necessary that the testator's signature be witnessed if the requirements for a holographic will are established. In re Will of Gilkey, 256 N.C. 415, 124 S.E.2d 155 (1962).

IV. FOUND AMONG VALUABLE PAPERS, ETC.

Location of Holographic Will. — The statute requires that a paper-writing sufficient to pass as a holographic will must be found, after the death of the testator, in one of five different places: (1) among the testator's valuable papers; (2) among the testator's valuable effects; (3) in a safe-deposit box; (4) in a safe place where it was deposited by the testator or under his authority; or (5) in the possession of a person or firm with whom it was deposited by the testator or under his authority for safekeeping. In re Will of Church, 121 N.C. App. 506, 466 S.E.2d 297 (1996).

Purpose of Requirement That Paper Be Found Among Valuable Papers. — The requirement of this section that the writing be found after death among testator's valuable papers was to show the author's evaluation of the document, important because lodged with important documents, to become effective upon death because left there by the author, thereby establishing the necessary animus testandi. In re Will of Gilkey, 256 N.C. 415, 124 S.E.2d 155 (1962).

What Constitutes Valuable Papers. — Valuable papers consist of such as are regarded by a decedent as worthy of preservation, and therefore in his estimation, of some value. Much depends upon the condition and business and habits of the decedent in respect to keeping his valuable papers. Winstead v. Bowman, 68 N.C. 170 (1873).

The requirements of this section that a paper-writing sufficient to pass as a holograph will must be found after the death of the testator among his valuable papers and (now "or") effects must be liberally construed, and where it is found among the deceased's papers and effects evidently regarded by him as his most valuable papers, and are in fact valuable, under circumstances showing his intention that that will should take effect as being so found, it is sufficient. In re Will of Groce, 196 N.C. 373, 145 S.E. 689 (1928). See also Hughes v. Smith, 64 N.C. 493 (1870); In re Williams' Will, 215 N.C. 259, 1 S.E.2d 857 (1939).

If a document had been placed among the author's valuable papers without his knowledge and consent, it would have no validity as a will even though found among the papers after the author's death. In re Will of Gilkey, 256 N.C. 415, 124 S.E.2d 155 (1962).

Writing Found in Drawer with Deeds and Other Papers. — Where the proof showed that the script propounded as a holograph will was found in a small drawer of a bookcase, in the room which the alleged testator occupied at his death, with his deeds and other papers, it was held to be such a finding "among the valuable papers of the decedent" as will, in connection with the other evidence required by the statute in respect to handwriting, authorize its probate. Cornelius v. Brawley, 109 N.C. 542, 14 S.E. 78 (1891).

Writing Found with Other Papers. — Finding a holographic will in a wooden bowl on the testator's kitchen counter did not entitle caveators to a directed verdict because other documents of a financial nature were found in the same place, and the testator was a man of limited education. In re Allen, 148 N.C. App. 526, 559 S.E.2d 556, 2002 N.C. App. LEXIS 33 (2002).

Deposit among Unopened Mail. — A bona fide controversy existed as to whether a holographic document was found among the valuable papers and effects of the testatrix, where the document was discovered among some unopened mail on a sofa at the testatrix's home, in a small room which was used as an office. Lenoir Rhyne College v. Thorne, 13 N.C. App. 27, 185 S.E.2d 303 (1971), cert. denied, 280 N.C. 721, 186 S.E.2d 924 (1972).

A paper-writing found after testator's death in the pockets of the clothes he was wearing, with large sums of money and other papers of value was held to be effective as his will. In re Will of Groce, 196 N.C. 373, 145 S.E. 689 (1928).

Stored in Separate Pocketbooks. — Where testator stored valuable belongings in her pocketbooks, which she kept in her bedroom, one pocketbook on the inside of her bedroom door contained insurance papers, the deed to her home and a bank book, and the handwritten document was in another pocketbook, also in her bedroom, in an envelope labelled "This is my Will", the evidence supported the trial court's finding that the handwriting was found in a "safe place." In re Will of Church, 121 N.C. App. 506, 466 S.E.2d 297 (1996).

Need Not Be Found among Most Valuable Papers. — The phrase "among the valuable papers and [now 'or'] effects," etc., used in this section does not necessarily and without exception mean among the most valuable papers, etc. So the fact that decedent kept valuable papers in a tin box in a bank which were intrinsically more valuable than papers kept in a trunk where the will was found would not prevent the latter from being a depository within the meaning of the section. Winstead v. Bowman, 68 N.C. 170 (1873).

Deposit among Useless Papers and Rubbish. — In Little v. Lockman, 49 N.C. 495 (1857), the script propounded was found in the drawer of a bureau, among some useless papers and rubbish, and there were valuable papers and effects kept in another drawer of the same bureau. Under such circumstances the court properly held that the script was not found in such a place of deposit as was contemplated by the statute. Hughes v. Smith, 64 N.C. 493 (1870).

Evidence of Finding Among Valuables. — That a holograph script was seen among the valuable papers and effects of the decedent eight months before his death is no evidence that it was found there at or after his death. Adams v. Clark, 53 N.C. 56 (1860).

Evidence that the will of the deceased, wholly written and signed by her, was found among her valuable papers after her death, in a desk where she kept her business papers and papers she desired to keep for their sentimental value, and that it was transferred after her death, together with the other papers, to her trunk where they were found, was held sufficient, under the circumstances of the case. In re Will of Westfeldt, 188 N.C. 702, 125 S.E. 531 (1924).

Evidence as to whether the document in question was found among the valuable papers and effects of the deceased or in a safe place where it was deposited by her, in satisfaction of subdivision (a)(3) of this section, was sufficient to support the jury's determination that it was a valid holographic will. Stephens v. McPherson, 88 N.C. App. 251, 362 S.E.2d 826 (1987).

Jury to Determine Intention in Depositing with Valuables. — It was entirely proper in the judge to leave it to the jury to determine whether, from all the circumstances, they believed that the paper-writing was deposited by the deceased among his valuable papers with the intention that it should be his will. Simms v. Simms, 27 N.C. 684 (1845); Hill v. Bell, 61 N.C. 122 (1867).

Deposit in a Trunk Left with a Friend for Safekeeping. — The placing of a holographic will in a trunk, left for safekeeping with a friend, and having it in the larger part of the valuable papers and money of the deceased, will satisfy the requirements of the statute upon the point of deposit. Hill v. Bell, 61 N.C. 122 (1867).

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Sufficient Signature. — Where the handwriting of a testator in a holographic will can be proved and there are no defects in other respects, it is sufficient signature for the testator in a holographic will to sign or write his name in his own handwriting in the body of the will. See opinion of Attorney General to Honorable Robert Miller, Clerk, Superior Court, Stokes County, 40 N.C.A.G. 36 (1969).

§ 31-3.5. Nuncupative will.

A nuncupative will is a will

(1) Made orally by a person who is in his last sickness or in imminent peril of death and who does not survive such sickness or imminent peril, and

(2) Declared to be his will before two competent witnesses simultaneously present at the making thereof and specially requested by him to bear witness thereto. (1953, c. 1098, s. 2.)

Cross References. — As to revocation of nuncupative will, see G.S. 31-5.2. As to manner of probate of nuncupative will, see G.S. 31-18.3.

CASE NOTES

"Last Sickness." — Where genuine issues of fact existed as to whether decedent reasonably believed he was in the last stage of a chronic disease and whether he was actually in his "last sickness," summary judgment was inappropriate. In re Will of Krantz, 135 N.C. App. 354, 520 S.E.2d 96 (1999).

Nuncupative Wills Not Precluded by Former § 31-3. — See Kennedy v. Douglas, 151 N.C. 336, 66 S.E. 216 (1909).

§ 31-3.6. Seal not required.

A seal is not necessary to the validity of a will. (1953, c. 1098, s. 2.)

§ 31-4. Execution of power of appointment by will.

No appointment, made by will in the exercise of any power, shall be valid unless the same be executed in the manner by law required for the execution of wills; and every will, executed in such manner, shall, so far as respects the execution and attestation thereof, be a valid execution of a power of appointment by will, notwithstanding it shall have been expressly required that a will made in exercise of such power should be executed with some additional or other form of execution or solemnity. (1844, c. 88, s. 9; R.C., c. 119, s. 4; Code, s. 2139; Rev., s. 3114; C.S., s. 4132.)

Cross References. — As to operation of general gift by will as execution of power of appointment, see G.S. 31-43.

Legal Periodicals. — For note, "Powers of Appointment—Does a General Residuary Clause Fulfill a Specific Reference Requirement?," see 65 N.C.L. Rev. 1475 (1987).

CASE NOTES

A provision calling for reference to a power of appointment does not concern the "execution and attestation" of a will within the meaning of this section. First Citizens Bank & Trust Co. v. Fleming, 77 N.C. App. 568, 335 S.E.2d 515 (1985).

In order to exercise a power of appointment calling for specific reference to the power before the power may be exercised, some reference to the power must be made. First Citizens Bank & Trust Co. v. Fleming, 77 N.C. App. 568, 335 S.E.2d 515 (1985).

Cited in First Union Nat'l Bank v. Moss, 32 N.C. App. 499, 233 S.E.2d 88 (1977).

Article 2.

Revocation of Will.

§ 31-5: Rewritten and renumbered as G.S. 31-5.1 by Session Laws 1953, c. 1098, s. 3.

§ 31-5.1. Revocation of written will.

A written will, or any part thereof, may be revoked only

(1) By a subsequent written will or codicil or other revocatory writing executed in the manner provided herein for the execution of written wills, or

(2) By being burnt, torn, canceled, obliterated, or destroyed, with the intent and for the purpose of revoking it, by the testator himself or by another person in his presence and by his direction. (1784, c. 204, s. 14; 1819, c. 1004, ss. 1, 2; 1840, c. 62; R.C., c. 119, s. 22; Code, s. 2176; Rev., s. 3115; C.S., s. 4133; 1945, c. 140; 1953, c. 1098, s. 3.)

CASE NOTES

I. General Consideration.
II. Subsequent Will or Codicil.
III. Physical Destruction.

I. GENERAL CONSIDERATION.

Editor's Note. *— Many of the cases cited below construe former G.S. 31-5.*

One lacking testamentary capacity is not competent to revoke a prior will. The same degree of mental capacity is necessary to revoke a will as to make one. In re Shute's Will, 251 N.C. 697, 111 S.E.2d 851 (1960).

Revocation of Holographic Will. — It seems clear that a holographic will may be revoked just as an attested will may, i.e., (1) by burning, tearing, canceling or obliterating or (2) by another will, which may be holographic or attested, provided only that the statutory requirements in each case are complied with. No witnesses are necessary on the holographic revocation. See 14 L.R.A. (n.s.) 968 (1908) and 112 Am. St. R. 822, 2 N.C.L. Rev. 110.

Effect of Disposal of Articles Already Bequeathed. — A bequest of personal property in a trunk which contained the holographic will and other valuable papers of the deceased, after removing certain articles specifically bequeathed to others, is not a revocation of her will by the testatrix. In re Foy, 193 N.C. 494, 137 S.E. 427 (1927).

Revocation by Parol Prior to Former § 31-5. — See Giles v. Giles, 1 N.C. 377 (1801), decided prior to the enactment of former § 31-5, where it is held that a will of real estate in writing may be revoked by parol if the words of revocation denote a present intention to revoke.

Revival by Parol Declaration. — A revocation of a will of real estate carried completely into effect cannot be revived by any subsequent declaration by parol. Giles v. Giles, 1 N.C. 377 (1801).

Issue of Revocation Is for Jury. — Probate is an in rem action and the issue of revocation raised by caveat is for determination by the jury, and the court may not grant a motion for directed verdict. In re Will of Hodgin, 10 N.C. App. 492, 179 S.E.2d 126 (1971).

But the trial judge does have authority to set aside the verdict in his discretion when the verdict is against the greater weight of the evidence. In re Will of Hodgin, 10 N.C. App. 492, 179 S.E.2d 126 (1971).

Instruction Held without Error. — See In re Gatling's Will, 234 N.C. 561, 68 S.E.2d 301 (1951).

Applied in Mansour v. Rabil, 277 N.C. 364, 177 S.E.2d 849 (1970).

Cited in In re Will of Burton, 267 N.C. 729, 148 S.E.2d 862 (1966); Craig v. Calloway, 68 N.C. App. 143, 314 S.E.2d 823 (1984); In re Will of Dunn, 129 N.C. App. 321, 500 S.E.2d 99 (1998), review dismissed and cert. denied, 348 N.C. 693, 511 S.E.2d 645 (1998).

II. SUBSEQUENT WILL OR CODICIL.

Revocatory Paper Must Be a Testamentary Paper. — Where the writing offered as operating a revocation of the will of the testator contains none of the elements of a testamentary paper, it cannot be helped by evidence aliunde, and hence has no revocatory effect. Davis v. King, 89 N.C. 441 (1883).

Presumption as to Second Will. — A will may be revoked by a subsequent instrument executed solely for that purpose, or by a subsequent will containing a revoking clause or provisions inconsistent with those of the previous will, or by any of the other methods prescribed by law; but the mere fact that a second will was made, although it purports to be the last, does not create a presumption that it revokes or is inconsistent with one of a prior date. Where testator devised a certain part of his lands to L, and by a later will gave his effects to his brothers and sisters, the two wills were not inconsistent and the latter did not revoke the former. In re Wolfe's Will, 185 N.C. 563, 117 S.E. 804 (1923).

Presumption Overcome by Evidence. — Caveators presented sufficient evidence to overcome the presumption that a testator destroyed his 2002 will with the intent to revoke it, and a directed verdict against the caveators was error; inter alia, the testator's attorney testified that testator never mentioned a desire to change the 2002 will, and there was also evidence that someone moved the testator's 1995 will after his death. In re Will of McFayden, 178 N.C. App. 704, 632 S.E.2d 520, 2006 N.C. App. LEXIS 1635 (2006), rev'd in part, — N.C. —, 635 S.E.2d 65 (2006).

Revocation by Codicil Not Containing Express Words of Revocation. — In the absence of express words of revocation, it is a rule of construction that for a codicil to revoke any part of a will its provisions must be so inconsistent with those of the will as to exclude any other legitimate inference than that the testator had changed his intentions. Yount v. Yount, 258 N.C. 236, 128 S.E.2d 613 (1962).

Evidence of the preparation of a later dispositive instrument, without evidence that it was ever executed according to the formalities necessary to make it a valid will and without evidence that it contained any words of revocation or provisions contrary to a prior will, duly executed, is insufficient evidence of revocation of the will to justify the submission of the question of revocation to the jury. In re Crawford's Will, 246 N.C. 322, 98 S.E.2d 29 (1957).

To establish the revocation of a will by a subsequent writing it is necessary to prove the revocation in the manner required to establish the validity of the paper-writing originally offered for probate. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Separation Agreement As Renunciation. — Where a husband executes a will devising and bequeathing all his property to his wife, the spouses thereafter enter a separation agreement in which each "waives and renounces all rights … under any previously executed will of the other," and the husband subsequently dies without having revoked or modified his will, the separation agreement constitutes a valid renunciation which adeems the devise and bequest to the wife. Sedberry v. Johnson, 62 N.C. App. 425, 302 S.E.2d 924 (1983), cert. denied, 309 N.C. 322, 307 S.E.2d 167 (1983).

Where caveators could not produce the revocatory writing, and where the decedent's attorney could not recall writing the will, the trial court erred in granting the caveators summary judgment on the ground that the will revoked an earlier will that had excluded the caveators as beneficiaries. In re Will of McCauley, 356 N.C. 91, 565 S.E.2d 88, 2002 N.C. LEXIS 550 (2002).

Caveators alleged a second will, the original of which was lost, revoked the testator's earlier will under G.S. 31-5.1; pursuant to G.S. 1A-1-42, the trial court did not abuse its discretion by trifurcating the case on three issues: (1) the validity of the earlier will; (2) whether the testator destroyed the later will; and (3) the validity of the later will, as these issues were separate, distinct, and compartmentalized. In re Will of McFayden, 179 N.C. App. 595, 635 S.E.2d 65, 2006 N.C. App. LEXIS 2053 (2006).

Trial court properly found insufficient evidence to support caveator's request for a jury instruction on revocation because there was no case precedent where a later-dated letter making no specific reference to a prior will, but merely declaring that the testator had "not written a will," was considered to be a revocation of a prior will. In re Estate of Lowe, 156 N.C. App. 616, 577 S.E.2d 315, 2003 N.C. App. LEXIS 189 (2003).

III. PHYSICAL DESTRUCTION.

Defacing, Cancellation or Obliteration Alone Insufficient to Show Revocation. — A paper-writing duly executed as a last will and testament was not revoked, in whole or in part, by defacing, cancellation, or obliteration, unless the testatrix defaced or obliterated the paper-writing, or some portion or portions thereof with the intent thereby to revoke it in whole or in part. Defacement or obliteration, even though shown to be made by testatrix, is not, alone, sufficient to show revocation. In re Will of Hodgin, 10 N.C. App. 492, 179 S.E.2d 126 (1971).

Material Alteration by Cancellation Necessary. — In order for there to be a revocation of a will, in whole or in part, under the provisions of this section there must not only exist the intent of the testator to cancel, but there must be the physical act of cancellation; and while it is not required that the words should be entirely effaced where the cancellation is in part, so as to make the same illegible, the portion erased must be of such significance as to effect a material alteration in the meaning of the will or the clause of the will that is challenged on the issue. In re Love's Will, 186 N.C. 714, 120 S.E. 479 (1923).

Same — Primary Controlling Clause Unaltered, Effect. — Where the primary or controlling clause of a will remains unaltered by the obliteration by the testator of words therein and the unobliterated words remaining are sufficient to carry the designated property to the devisee, it will not amount to a revocation within the intent and meaning of this section; nor will the obliteration of the name of another beneficiary be sufficient as to him, when it appears that the intent of the revocation by the testator was dependent upon the successful revocation of a principal devise wherein the erasures were insufficient to effectuate a legal cancellation. In re Love's Will, 186 N.C. 714, 120 S.E. 479 (1923).

Interlineations and Annotations Held Insufficient to Show Revocation. — Where testator, in his own handwriting, makes certain interlineations and annotations upon his will, which had been properly executed, and marks through certain words of the will, and it appears that such alterations are insufficient to constitute a holographic will and were made with the intent of altering the will at some future date in accordance with the notations, but that such alterations were not made with the intent to revoke the will in whole or in part, such interlineations and annotations are insufficient to show a revocation of the will, intent to revoke being essential to revocation by defacement or obliteration of the will by testator under this section. In re Will of Roediger, 209 N.C. 470, 184 S.E. 74 (1936).

Presumption of Revocation Where Will Cannot Be Found. — It being shown that a will was once in existence and last heard of in possession of the testator, but could not be found after his death, a presumption arises that it was destroyed by his consent with intent to cancel it. Such presumption is not conclusive, but it imposes upon the person asserting the will the burden of proving that it was not so destroyed, or that the testator was not of sound mind at the time of such presumed destruction. Scoggins v. Turner, 98 N.C. 135, 3 S.E. 719 (1887).

Presumption of Revocation Rebutted. — Caveators alleged a second will, the original of which was lost, revoked the testator's earlier will pursuant to G.S. 31-5.1, as they presented evidence that the testator was not responsible for the loss of the later will, and they rebutted the presumption that it was destroyed; therefore, the trial court erred in granting the propounder of the first will a directed verdict under G.S. 1A-1-50. In re Will of McFayden, 179 N.C. App. 595, 635 S.E.2d 65, 2006 N.C. App. LEXIS 2053 (2006).

§ 31-5.2. Revocation of nuncupative will.

A nuncupative will or any part thereof may be revoked

(1) By a subsequent nuncupative will, or

(2) By a subsequent written will or codicil or other revocatory writing executed in the manner provided herein for the execution of written wills. (1953, c. 1098, s. 4.)

§ 31-5.3. Will not revoked by marriage; dissent from will made prior to marriage.

A will is not revoked by a subsequent marriage of the maker; and the surviving spouse may petition for an elective share when there is a will made prior to the marriage in the same manner, upon the same conditions, and to the same extent, as a surviving spouse may petition for an elective share when there is a will made subsequent to marriage. (1844, c. 88, s. 10; R.C., c. 119, s. 23; Code, s. 2177; Rev., s. 3116; C.S., s. 4134; 1947, c. 110; 1953, c. 1098, s. 5; 1967, c. 128; 2000-178, s. 5.)

Cross References. — As to right of elective share, see G.S. 30-3.1 et seq.

Legal Periodicals. — For survey of 1973 case law on the revocation of wills by subsequent marriage, see 52 N.C.L. Rev. 949 (1974).

CASE NOTES

Will Revoked under Prior Provisions Not Revived by 1967 Revision. — Where testator's will made in January 1963 was revoked under former provisions under this section by his marriage in November 1963, the will was not revived by the 1967 revision of this section providing that no will should be revoked by any change in the marital status of the maker. In re Probate of Will of Mitchell, 285 N.C. 77, 203 S.E.2d 48 (1974).

Prior Law. — For cases decided under prior provisions, see Sawyer v. Sawyer, 52 N.C. 133 (1859); Means v. Ury, 141 N.C. 248, 53 S.E. 850 (1906); In re Will of Bradford, 183 N.C. 4, 110 S.E. 586 (1922); In re Coffield's Will, 216 N.C. 285, 4 S.E.2d 870 (1939); In re Tenner's Will, 248 N.C. 72, 102 S.E.2d 391 (1958).

Applied in Potter v. Clark, 229 N.C. 350, 49 S.E.2d 636 (1948); Sinclair v. Travis, 231 N.C. 345, 57 S.E.2d 394 (1950).

Cited in In re Will of Watson, 213 N.C. 309, 195 S.E. 772 (1938); McCraw v. Llewellyn, 256 N.C. 213, 123 S.E.2d 575 (1962); Ivery v. Ivery, 258 N.C. 721, 129 S.E.2d 457 (1963).

§ 31-5.4. Revocation by divorce or annulment; revival.

Dissolution of marriage by absolute divorce or annulment after making a will does not revoke the will of any testator but, unless otherwise specifically provided in the will, it revokes all provisions in the will in favor of the testator's former spouse or purported former spouse, including, but not by way of limitation, any provision conferring a general or special power of appointment on the former spouse or purported former spouse and any appointment of the former spouse or purported former spouse as executor, trustee, conservator, or guardian. If provisions are revoked solely by this section, they are revived by the testator's remarriage to the former spouse or purported former spouse. (1953, c. 1098, s. 6; 1977, c. 74, s. 3; 1991, c. 587, s. 1.)

CASE NOTES

"Divorce" Is Used in General and Comprehensive Sense. — In enacting this section the General Assembly used the word "divorce" in its general and comprehensive sense, that is, as denoting a judgment or decree by which a marriage is dissolved or annulled, rather than in its limited and technical sense. Ivery v. Ivery, 258 N.C. 721, 129 S.E.2d 457 (1963).

Former Spouse Denied A Testate Disposition. — Where decedent failed to provide in his will that, even if he divorced the former spouse, she would remain a beneficiary, under G.S. 31-5.4 the former spouse was denied any testate disposition, despite the former spouse's designation as a beneficiary in the decedent's pre-divorce will. Gibboney v. Wachovia Bank, N.A., 174 N.C. App. 834, 622 S.E.2d 162, 2005 N.C. App. LEXIS 2587 (2005).

§ 31-5.5. After-born or after-adopted child; illegitimate child; effect on will.

(a) A will shall not be revoked by the subsequent birth of a child to the testator, or by the subsequent adoption of a child by the testator, or by the subsequent entitlement of an after-born illegitimate child to take as an heir of the testator pursuant to the provisions of G.S. 29-19(b), but any after-born, after-adopted or entitled after-born illegitimate child shall have the right to share in the testator's estate to the same extent he would have shared if the testator had died intestate unless:

(1) The testator made some provision in the will for the child, whether adequate or not;
(2) It is apparent from the will itself that the testator intentionally did not make specific provision therein for the child;
(3) The testator had children living when the will was executed, and none of the testator's children actually take under the will;
(4) The surviving spouse receives all of the estate under the will; or

(5) The testator made provision for the child that takes effect upon the death of the testator, whether adequate or not.

(b) The provisions of G.S. 28A-22-2 shall be construed as being applicable to after-adopted children and to after-born children, whether legitimate or entitled illegitimate.

(c) The terms "after-born," "after-adopted" and "entitled after-born" as used in this section refer to children born, adopted or entitled subsequent to the execution of the will. (1868-9, c. 113, s. 62; Code, s. 2145; Rev., s. 3145; C.S., s. 4169; 1953, c. 1098, s. 7; 1955, c. 541; 1973, c. 1062, s. 2; 1985, c. 689, s. 9; 1995, c. 161, s. 1; 1997-456, s. 55.8.)

Legal Periodicals. — For comment on sufficiency of life insurance as provision for after-born child, see 29 N.C.L. Rev. 218 (1951).

For note on the inheritance rights of an after-adopted child, see 30 N.C.L. Rev. 276 (1952).

For article on interstate and foreign adoptions in North Carolina, see 40 N.C.L. Rev. 691 (1962).

For casenote: "The Established Standard for Fathers Who Have Acknowledged Paternity and Who Are Seeking Custody of Their Illegitimate Child(ren): Rosero v. Blake, 357 N.C. 193 (2003)," see 26 N.C. Cent. L.J. 116 (2003).

CASE NOTES

Editor's Note. — *Some of the cases cited below construe former G.S. 31-45.*

For rules under common law and civil law, see Christian v. Carter, 193 N.C. 537, 137 S.E. 596 (1927).

A testator is not required to mention by name or make some provision for a child in order to disinherit that child under North Carolina law, even if the child is born or adopted after the will is made. Ladd v. Estate of Kellenberger, 314 N.C. 477, 334 S.E.2d 751 (1985).

After-Born Child Takes Share Unless Provided for or Intentionally Excluded. — A child born after a will is executed takes as in case of intestacy, unless (1) provision is made for it in the will, or (2) it appears from the will itself that the testator's failure to make provision was intentional. Wachovia Bank & Trust Co. v. McKee, 260 N.C. 416, 132 S.E.2d 762 (1963).

Will Is Only Source of Intent to Exclude. — The court is limited to the will as the source from which intent to exclude must appear. Wachovia Bank & Trust Co. v. McKee, 260 N.C. 416, 132 S.E.2d 762 (1963).

Intent to Exclude Is Not Shown by Will Ignoring All Children. — Where after-born children, in fact all children, are ignored in a will, the court cannot say the will discloses an intent to exclude after-born children. It is limited to the will as the source from which intent to exclude must appear. Since such intent does not appear from the will, the after-born children of the testator take as in case of their father's intestacy. Wachovia Bank & Trust Co. v. McKee, 260 N.C. 416, 132 S.E.2d 762 (1963).

Entire Will Is Not Revoked. — While after-born children not provided for in the will of their deceased parent may claim by inheritance their part of the estate, under this section, it does not amount to revocation of the entire will. Fawcett v. Fawcett, 191 N.C. 679, 132 S.E. 796 (1926).

After-Born Child of Intestate Shares in Estate. — This statutory provision clearly assumes and contemplates that an after-born child of an intestate shares in the estate, both real and personal, of such intestate. Byerly v. Tolbert, 250 N.C. 27, 108 S.E.2d 29 (1959).

A posthumous child was provided for under her father's will, though no direct, specific provision was made, where by the residuary clause the will made substantial provision for a class to which the posthumous child was a member. Sheppard v. Kennedy, 242 N.C. 529, 88 S.E.2d 760 (1955).

Child Born after Execution of Will but before Execution of Codicil. — A codicil operates as a republication of the original will and makes it speak as of the date of the execution of the codicil insofar as it is not altered or revoked by the codicil, and therefore a child born after the execution of the will, but before the execution of the codicil, is not entitled to such share in the estate as though testator had died intestate, it being apparent that testator intentionally did not make specific provision for such child. Young v. Williams, 253 N.C. 281, 116 S.E.2d 778 (1960).

No Intention to Direct Parent to Make Provision for Child. — Former G.S. 31-45 was construed as not intending to control a parent as to the provision he should make for his child, but was to apply when by inadvertence or mistake the after-born child had not been provided for. Unless the omission was intentional, or provision was made for the child, either under the will or some settlement or provision ultra, the after-born child took his share, and the statute applied where there were one or more children. Flanner v. Flanner, 160 N.C. 126, 75 S.E. 936 (1912).

Adequacy of Provision for After-Born Child. — While the courts will not inquire into the adequacy of provision made for a child born after the execution of the will within the purport of this section such provision must be of reasonable substance and value in praesenti. Williamson v. Williamson, 232 N.C. 54, 59 S.E.2d 214 (1950).

As long as a testator makes some provision in the will for an after-born child, whether adequate or not, the child has no right to take an intestate share of the testator's estate, and a class gift constituted a provision for an afterborn child, even though the gift was contingent. Mason v. Stanimer, 102 N.C. App. 673, 403 S.E.2d 605 (1991).

"Making Provision" under Former § 31-45. — See Meares v. Meares, 26 N.C. 192 (1843); King v. Davis, 91 N.C. 142 (1884); Thomason v. Julian, 133 N.C. 309, 45 S.E. 636 (1903). See also Rawls v. Durham Realty & Ins. Co., 189 N.C. 368, 127 S.E. 254 (1925); Nicholson v. Nicholson, 190 N.C. 122, 129 S.E. 148 (1925).

Procurement of Insurance. — Testator had two children, one born before and one after the execution of his will. No testamentary provision was made for either child, but testator, after the birth of the second child, procured a policy of life and accident insurance on his life, making both the children beneficiaries therein. It was held that the procurement of the policy was not such a provision for the after-born child as to prevent such child from participating in his father's property as heir and distributee. Williamson v. Williamson, 232 N.C. 54, 59 S.E.2d 214 (1950).

Knowledge of Testator as to Child En Ventre Sa Mere Immaterial. — The beneficient provisions of this section are not affected by the presumptive knowledge of the father, from the condition of his wife, that at the time he made the will he must have anticipated the birth, but upon the fact that the child was born thereafter. It is the subsequent birth, not the father's knowledge, which effects the partial revocation. Christian v. Carter, 193 N.C. 537, 137 S.E. 596 (1927).

Applicability of Former § 31-45 to Adopted Children or Illegitimate Children. — See King v. Davis, 91 N.C. 142 (1884); Fawcett v. Fawcett, 191 N.C. 679, 132 S.E. 796 (1926); Sorrell v. Sorrell, 193 N.C. 439, 137 S.E. 306 (1927). See also 12 N.C.L. Rev. 402 (1934).

Applied in Johnson v. Johnson, 256 N.C. 485, 124 S.E.2d 172 (1962); Scott v. Jackson, 257 N.C. 658, 127 S.E.2d 234 (1962).

Cited in Outlaw v. Planters Nat'l Bank & Trust Co., 41 N.C. App. 571, 255 S.E.2d 189 (1979); Rosero v. Blake, 357 N.C. 193, 581 S.E.2d 41, 2003 N.C. LEXIS 605 (2003), cert. denied, 540 U.S. 1177, 124 S. Ct. 1407, 158 L. Ed. 2d 78 (2004).

§ 31-5.6. No revocation by subsequent conveyance.

No conveyance or other act made or done subsequently to the execution of a will of, or relating to, any real or personal estate therein comprised, except an act by which such will shall be duly revoked, shall prevent the operation of the will with respect to any estate or interest in such real or personal estate as the testator shall have power to dispose of by will at the time of his death. (1844, c. 88, s. 2; R.C. c. 119, s. 25; Code, s. 2179; Rev., s. 3118; C.S., s. 4136; 1953, c. 1098, s. 8.)

Legal Periodicals. — For article discussing the North Carolina Supreme Court's interpretation of this section, see 19 Wake Forest L. Rev. 151 (1983).

CASE NOTES

Editor's Note. — *The cases decided below were decided under former G.S. 31-8.*

Conveyance, etc., Not to Affect Provisions of Will. — No conveyance or act done after the execution of a will, unless it amounts to a revocation, will affect its provisions. Wood v. Cherry, 73 N.C. 110 (1875).

Parol evidence is incompetent to fasten upon a devise of land a constructive or implied trust in favor of another. Former G.S. 31-8 was enacted in view of the decision in Cook v. Redman, 37 N.C. 623 (1843), in which such a trust was upheld. Chappell v. White, 146 N.C. 571, 60 S.E. 635 (1908).

Applied in Wood v. Cherry, 73 N.C. 110 (1875), cited in Pittman v. Pittman, 107 N.C. 159, 12 S.E. 61 (1890); Cobb v. Edwards, 117 N.C. 244, 23 S.E. 241 (1895); Herring v. Sutton, 129 N.C. 107, 39 S.E. 772 (1901); Sykes v. Boone, 132 N.C. 199, 43 S.E. 645 (1903); Avery

v. Stewart, 136 N.C. 426, 48 S.E. 775 (1904); Chappell v. White, 146 N.C. 571, 60 S.E. 635 (1908).

Cited in In re Estate of Washburn, 158 N.C. App. 457, 581 S.E.2d 148, 2003 N.C. App. LEXIS 1148 (2003).

§ 31-5.7. Specific provisions for revocation exclusive; effect of changes in circumstances.

No will can be revoked in whole or in part by any act of the testator or by a change in his circumstances or condition except as provided by G.S. 31-5.1 through 31-5.6 inclusive. (1953, c. 1098, s. 9.)

CASE NOTES

Mental Incompetency Does Not Revoke Will. — The fact that a testator became mentally incompetent to manage his business affairs or to understand the extent of his holdings, even if the mental condition continued to his death would not revoke his will in whole or in part. Abbott v. Abbott, 269 N.C. 579, 153 S.E.2d 39 (1967).

§ 31-5.8. Revival of revoked will.

No will or any part thereof that has been in any manner revoked can, except as provided in G.S. 31-5.4, be revived otherwise than by a reexecution thereof, or by the execution of another will in which the revoked will or part thereof is incorporated by reference. (1953, c. 1098, s. 10; 1991, c. 587, s. 2.)

Legal Periodicals. — For survey of 1973 case law on the revocation of wills by subsequent marriage, see 52 N.C.L. Rev. 949 (1974).

CASE NOTES

Applied in In re Will of Farr, 277 N.C. 86, 175 S.E.2d 578 (1970).

Cited in In re Probate of Will of Mitchell, 19 N.C. App. 236, 198 S.E.2d 233 (1973); In re Probate of Will of Mitchell, 285 N.C. 77, 203 S.E.2d 48 (1974); In re Will of McCauley, 356 N.C. 91, 565 S.E.2d 88, 2002 N.C. LEXIS 550 (2002).

§ **31-6:** Renumbered as G.S. 31-5.3 by Session Laws 1953, c. 1098, s. 5.

§ **31-7:** Repealed by Session Laws 1953, c. 1098, s. 9.

§ **31-8:** Renumbered as G.S. 31-5.6 by Session Laws 1953, c. 1098, s. 8.

ARTICLE 3.

Witnesses to Will.

§ 31-8.1. Who may witness.

Any person competent to be a witness generally in this State may act as a witness to a will. (1953, c. 1098, s. 15.)

Legal Periodicals. — For article, “Abolishing the Attestation Requirement for Wills,” see 68 N.C.L. Rev. 541 (1990).

§ 31-9. Executor competent witness.

No person, on account of being an executor of a will, shall be incompetent to be admitted a witness to prove the execution of such will, or to prove the validity or invalidity thereof. (R.C., c. 119, s. 9; Code, s. 2146; Rev., s. 3119; C.S., s. 4137.)

CASE NOTES

Purpose of Section. — This section was intended to give the benefit of an executor's testimony to every person who should be interested, either in the establishment, or defeat of a paper-writing propounded as a will. Pannell v. Scoggin, 53 N.C. 408 (1861).

May Be Examined for Both Parties. — Under this section one named as executor in a receipt, propounded as a will, though named as plaintiff in an issue devisavit vel non, may be examined as a witness for the caveator as well as for the propounder. Pannell v. Scoggin, 53 N.C. 408 (1861).

Competent Even if Subscribing Witness or Interest Later Acquired. — An executor or administrator cum testamento annexo, who is also a subscribing witness to a will, is competent to testify to the execution thereof; and the same rule applies to one who was competent at the time of the making of the will, but subsequently acquired an interest therein. Vester v. Collins, 101 N.C. 114, 7 S.E. 687 (1888).

§ 31-10. Beneficiary competent witness; when interest rendered void.

(a) A witness to an attested written or a nuncupative will, to whom or to whose spouse a beneficial interest in property, or a power of appointment with respect thereto, is given by the will, is nevertheless a competent witness to the will and is competent to prove the execution or validity thereof. However, if there are not at least two other witnesses to the will who are disinterested, the interested witness and his spouse and anyone claiming under him shall take nothing under the will, and so far only as their interests are concerned the will is void.

(b) A beneficiary under a holographic will may testify to such competent, relevant and material facts as tend to establish such holographic will as a valid will without rendering void the benefits to be received by him thereunder. (R.C., c. 119, s. 10; Code, s. 2147; Rev., s. 3120; C.S., s. 4138; 1953, c. 1098, s. 11; 1955, c. 73, s. 2.)

CASE NOTES

Devise, etc., to Attesting Witness Only Void. — This section avoids only the devise or bequest to the attesting witness and to his and her wife or husband and privies, and leaves the other dispositions made of the testator's property in unimpaired force and operation. Vester v. Collins, 101 N.C. 114, 7 S.E. 687 (1888).

Interest of One Who Signs, But Not as Witness, Not Avoided. — One who signs his name on a will in the place where subscribing witnesses usually sign, is not deprived of benefits conferred upon him by the will, if he, in fact, did not sign as a subscribing witness. Boone v. Lewis, 103 N.C. 40, 9 S.E. 644 (1889).

Devisee May Testify to Finding Script Among Valuable Papers. — The widow and devisee of the testator is a competent witness to prove the fact that the script propounded was found among the valuable papers of the deceased. Cornelius v. Brawley, 109 N.C. 542, 14 S.E. 78 (1891).

Competency of Witness Is Question of Law. — If a witness to a will is interested as a legatee thereunder, he is a competent witness to prove the will, the effect being to deprive him of the legacy and it is error in the judge to submit the competency of a witness as a question of fact for the jury. The competency of a witness is a question for the court, to be raised when he offers to testify, and to be determined by the court. McLean v. Elliott, 72 N.C. 70 (1875).

Beneficiaries Under Contested Will Generally Are Not Competent. — The legislature, in enacting subsection (b), did not intend to alter the long standing rule that beneficiaries under a contested will are not competent witnesses to testify as to oral communications with the deceased which tend to answer the ultimate question for the jury in such cases. In re Will of Lamparter, 348 N.C. 45, 497 S.E.2d 692 (1998).

Exception to Dead Man's Statute. — With regard to a holographic will, an exception to the Dead Man's Statute has evolved which allows beneficiaries to testify as to the three material elements of a will: the testator's handwriting, the testator's signature; and what the testator considered to be his place for keeping valuable players. In re Will of Lamparter, 348 N.C. 45, 497 S.E.2d 692 (1998).

Application of Section to Holographic Wills Prior to 1955 Amendment. — See Hampton v. Hardin, 88 N.C. 592 (1883), overruled by McEwan v. Brown, 176 N.C. 249, 97 S.E. 20 (1918); In re Will of Westfeldt, 188 N.C. 702, 125 S.E. 531 (1924).

Applied in Cox v. Beaufort County Lumber Co., 124 N.C. 78, 32 S.E. 381 (1899); Barrett v. Williams, 215 N.C. 131, 1 S.E.2d 366 (1939); In re Crawford's Will, 246 N.C. 322, 98 S.E.2d 29 (1957); Brown v. Byrd, 252 N.C. 454, 113 S.E.2d 804 (1960).

Cited in Brickhouse v. Brickhouse, 104 N.C. App. 69, 407 S.E.2d 607 (1991).

§ 31-10.1. Corporate trustee not disqualified by witnessing of will by stockholder.

A corporation named as a trustee in a will is not disqualified to act as trustee by reason of the fact that a person owning stock in the corporation signed the will as a witness. (1949, c. 44.)

Article 4.

Depository for Wills.

§ 31-11. Depositories in offices of clerks of superior court where living persons may file wills.

The clerk of the superior court in each county of North Carolina shall be required to keep a receptacle or depository in which any person who desires to do so may file his or her will for safekeeping; and the clerk shall, upon written request of the testator, or the duly authorized agent or attorney for the testator, permit said will or testament to be withdrawn from said depository or receptacle at any time prior to the death of the testator: Provided, that the contents of said will shall not be made public or open to the inspection of anyone other than the testator or his duly authorized agent until such time as the said will shall be offered for probate. (1937, c. 435, s. 1; 1971, c. 528, s. 28.)

Local Modification. — Guilford: 1937, c. 435, s. 2.

Legal Periodicals. — As to this section, see 15 N.C.L. Rev. 353 (1937).

CASE NOTES

Testator Entitled to Inspect Will. — In a proceeding by petitioner to inquire into the mental state of respondent, his aged uncle, and to have a trustee appointed for him, the petitioner testified in substance that he was only interested in the welfare of respondent. It was held that respondent was entitled to examine his own will which had been deposited in a sealed envelope with the court clerk for the purpose of showing that petitioner was the principal devisee under the will. In re Gamble, 244 N.C. 149, 93 S.E.2d 66 (1956).

Without Written Request. — Provision of this section requiring written request of testator for permission to withdraw will from depository or receptacle does not apply to his request for inspection of will. In re Gamble, 244 N.C. 149, 93 S.E.2d 66 (1956).

§§ 31-11.1 through 31-11.5: Reserved for future codification purposes.

ARTICLE 4A.

Self-Proved Wills.

§ 31-11.6. How attested wills may be made self-proved.

(a) Any will may be simultaneously executed, attested, and made self-proved, by acknowledgment thereof by the testator and affidavits of the witnesses, each made before an officer authorized to administer oaths under the laws of the state where execution occurs and evidenced by the officer's certificate, under official seal, in substantially the following form:

"I, ______________, the testator, sign my name to this instrument this ________ day of ____________, ________ and being first duly sworn, do hereby declare to the undersigned authority that I sign and execute this instrument as my last will and that I sign it willingly (or willingly direct another to sign for me), that I execute it as my free and voluntary act for the purposes therein expressed, and that I am eighteen years of age or older, of sound mind, and under no constraint or undue influence.

____
Testator

We ______________, ______________, the witnesses, sign our names to this instrument, being first duly sworn, and do hereby declare to the undersigned authority that the testator signs and executes this instrument as his last will and that he signs it willingly (or willingly directs another to sign for him), and that each of us, in the presence and hearing of the testator, hereby signs this will as witness to the testator's signing, and to the best of our knowledge the testator is eighteen years of age or older, of sound mind, and under no constraint or undue influence.

____
Witness

____
Witness

THE STATE OF ____________.
COUNTY OF ____________.

Subscribed, sworn to and acknowledged before me by ______________. the testator and subscribed and sworn to before me by ______________ and ______________, witnesses, this ________ day of ______________
(SEAL)

(SIGNED) ______________________________

____
(OFFICIAL CAPACITY OF OFFICER)"

(b) An attested written will executed as provided by G.S. 31-3.3 may at any time subsequent to its execution be made self-proved, by the acknowledgment thereof by the testator and the affidavits of the attesting witnesses, each made before an officer authorized to administer oaths under the laws of this State, and evidenced by the officer's certificate, under official seal, attached or annexed to the will in form and content substantially as follows:

"STATE OF NORTH CAROLINA
"COUNTY/CITY OF ______________

"Before me, the undersigned authority, on this day personally appeared ______________, and ______________, known to me to be the testator and the witnesses, respectively, whose names are signed to the attached or foregoing instrument and, all of these persons being by me first duly sworn. The testator, declared to me and to the witnesses in my presence: That said instrument is his last will; that he had willingly signed or directed another to sign the same for him, and executed it in the presence of said witnesses as his free and voluntary act for the purposes therein expressed; or, that the testator signified that the instrument was his instrument by acknowledging to them his signature previously affixed thereto.

The said witnesses stated before me that the foregoing will was executed and acknowledged by the testator as his last will in the presence of said witnesses who, in his presence and at his request, subscribed their names thereto as attesting witnesses and that the testator, at the time of the execution of said will, was over the age of 18 years and of sound and disposing mind and memory.

____
Testator

____
Witness

____
Witness

____
Witness

Subscribed, sworn and acknowledged before me by ____________, the testator, subscribed and sworn before me by ____________, ____________ and ____________ witnesses, this _______ day of __________, A.D. _______
(SEAL)

(SIGNED) __________________________

____
(OFFICIAL CAPACITY OF OFFICER)"

(c) The sworn statement of any such witnesses taken as herein provided shall be accepted by the court as if it had been taken before such court. (1977, c. 795, s. 1; 1979, c. 536, s. 1; 1981, c. 599, s. 8; 1999-456, s. 59.)

Editor's Note. — Session Laws 1977, c. 795, which enacted this Article, provides, in s. 3, that: "This act shall apply to any attested written will in existence on or executed after the effective date of this act [Oct. 1, 1977]."

Session Laws 1979, c. 536, which, effective Oct. 1, 1979, designated the former provisions of the section as subsections (b) and (c) and added subsection (a), and in subsection (b), the amendment substituted "any time subsequent to its execution" for "the time of its execution or at any subsequent date" near the beginning of the introductory paragraph, provided in s. 2, effective May 9, 1979, that: "The execution of an acknowledgment of a will by a testator, and of the affidavits of witnesses, made before an officer authorized to administer oaths under the laws of this State and evidenced by the officer's certificate substantially in the form set out in G.S. 31-11.6 during the period between October 1, 1977 and October 1, 1979 shall be considered to be a valid execution and attestation of a written will even though the will was not signed and attested under the provisions of G.S. 31-3.3 separately from the execution of the acknowledgment by the testator and the affidavits of the witnesses. Such wills may be probated in accordance with G.S. 31-18.1(a)(4)."

Session Laws 1981, c. 599, which substituted "Any" for "In addition to the procedures for the execution of a will set out in G.S. 31-3.3, any" at the beginning of subsection (a), provided, in s. 9, that: "The execution of an acknowledgment of a will by a testator, and of the affidavits of witnesses, made before an officer authorized to administer oaths under the laws of this State and evidenced by the officer's certificate substantially in the form set out in G.S. 31-11.6 if done during the period between October 1, 1979, and the effective date of this act [October 1, 1979], shall be considered to be a valid execution and attestation of a written will regardless of whether or not the will was signed and attested under the provisions of G.S. 31-3.3 separately from the execution of the acknowledgment by the testator and the affidavits of the witnesses. Such wills may be probated in accordance with G.S. 31-18.1(a)(4)."

Session Laws 1981, c. 599, s. 21, provided that the act would not affect pending litigation.

Legal Periodicals. — For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For comment on the seal in North Carolina and the need for reform, see 15 Wake Forest L. Rev. 251 (1979).

For article, "Abolishing the Attestation Requirement for Wills," see 68 N.C.L. Rev. 541 (1990).

CASE NOTES

Witness' Failure to Remember Witnessing Will. — Where the caveators could not produce the revocatory writing, and where one witness did not remember witnessing the will, the trial court erred in granting the caveators summary judgment on the ground that the will revoked an earlier will that had excluded the caveators as beneficiaries. In re Will of McCauley, 356 N.C. 91, 565 S.E.2d 88, 2002 N.C. LEXIS 550 (2002).

Cited in In re Campbell, 155 N.C. App. 441, 573 S.E.2d 550, 2002 N.C. App. LEXIS 1639 (2002), cert. denied, 357 N.C. 63, 579 S.E.2d 385 (2003).

ARTICLE 5.

Probate of Will.

§ 31-12. Executor may apply for probate.

Any executor named in a will may, at any time after the death of the testator, apply to the clerk of the superior court, having jurisdiction, to have the same admitted to probate. Such will shall not be valid or effective to pass real estate or personal property as against innocent purchasers for value and without notice, unless it is probated or offered for probate within two years after the death of the testator or devisor or prior to the time of approval of the final account of a duly appointed administrator of the estate of the deceased, whichever time is earlier. If such will is fraudulently suppressed, stolen or destroyed, or has been lost, and an action or proceeding shall be commenced within two years from the death of the testator or devisor to obtain said will or establish the same as provided by law, then the limitation herein set out shall only begin to run from the termination of said action or proceeding, but not otherwise. (C.C.P., s. 439; Code, s. 2151; Rev., s. 3122; 1919, c. 15; C.S., s. 4139; 1921, c. 99; 1923, c. 14; 1953, c. 920, s. 2; 1975, c. 300, s. 13.)

Cross References. — As to disqualification of clerk, see G.S. 7A-104. As to jurisdiction with respect to an estate or trust where the clerk otherwise having jurisdiction is a subscribing witness to the will or has an interest in the estate or trust, see G.S. 28A-2-3. As to rights of innocent purchasers when will withheld from probate, see G.S. 31-39.

Legal Periodicals. — As to purpose of 1921 and 1923 amendments to this section, see 1 N.C.L. Rev. 314 (1923).

For note on "Two Methods of Probate in Solemn Form in North Carolina," see 30 N.C.L. Rev. 470 (1952).

For note as to procedure for probate upon death of survivor of testators of joint will, see 35 N.C.L. Rev. 345 (1957).

For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

CASE NOTES

This section and § 31-15 require the probate of a will, by implication at least. Wells v. Odum, 207 N.C. 226, 176 S.E. 563 (1934).

The word "probate" when used in reference to a document purporting to be a will means the judicial process by which a court of competent jurisdiction in a duly constituted proceeding tests the validity of the instrument before the court, and ascertains whether or not it is the last will of the deceased. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963); In re Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

It is the duty of a person named as executor to apply to the court having jurisdiction to have the writing probated. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Jurisdiction of Clerk. — This section confers upon the clerk of the superior court exclusive and original jurisdiction of proceedings for the probate of wills. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950); Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956).

The clerk of the superior court has exclusive and original jurisdiction over the probate of wills. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Title Descends to Heirs Subject to Being Divested. — The title of the land descends to the heirs of the testator, subject to being divested in favor of the devisee, when the will is duly admitted to probate. Floyd v. Herring, 64 N.C. 409 (1870).

Citation to those in interest is not necessary to the probate of a will in common form, the proceeding being ex parte, and when probated the paper-writing is valid and operative as a will and may not be attacked collaterally. In re Rowland, 202 N.C. 373, 162 S.E. 897 (1932). See In re Will of Etheridge, 231 N.C. 502, 57 S.E.2d 768 (1950).

The probate of a will in common form without citation to those in interest "to see the proceedings," is an ex parte proceeding and not binding on caveators upon the issue of devisavit vel non raised in their direct attack upon the validity of the will, and the admission in evidence in the caveat proceedings of the order of probate constitutes reversible error. Wells v. Odum, 205 N.C. 110, 170 S.E. 145 (1933). See also In re Will of Etheridge, 231 N.C. 502, 57 S.E.2d 768 (1950).

Appointment Is Reviewable. — The power, conferred by this section, to appoint administrators is reviewable by the judge of the superior court of the county. In re Estate of Wright, 200 N.C. 620, 158 S.E. 192 (1931).

Limitation on Probate under Former Law. — See McCormick v. Jernigan, 110 N.C. 406, 14 S.E. 971 (1892); Steadman v. Steadman, 143 N.C. 345, 55 S.E. 784 (1906).

Primary object in interpreting a will is to give effect to the intention of the testator. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Presumption Against Intestacy. — It is a long-standing policy of the State of North Carolina to construe a will with the presumption that the testator did not intend to die intestate with respect to any part of his property. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Cited in In re Will of Wood, 240 N.C. 134, 81 S.E.2d 127 (1954); In re Will of Covington, 252 N.C. 551, 114 S.E.2d 261 (1960); In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970); Bueltel v. Lumber Mut. Ins. Co., 134 N.C. App. 626, 518 S.E.2d 205, 1999 N.C. App. LEXIS 865 (1999), cert. denied, 351 N.C. 186, 541 S.E.2d 709 (1999).

§ 31-13. Executor failing, beneficiary may apply.

If no executor apply to have the will proved within 60 days after the death of the testator, any devisee or legatee named in the will, or any other person interested in the estate, may make such application, upon 10 days' notice thereof to the executor. (C.C.P., s. 440; Code, s. 2152; Rev., s. 3123; C.S., s. 4140.)

Cross References. — As to who may apply for letters of administration in case of intestacy, see G.S. 28A-4-1 and 28A-4-2.

CASE NOTES

"Persons Interested in the Estate." — It is obvious from this section that the classification of a "person interested in the estate" includes persons who are neither devisees nor legatees. It is broad enough to include even a person whose interest in the estate is in opposition to the will. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

The designation of a person who exhibited a document for probate as "one of the executors therein named," though inaccurate, is not an affirmative showing that he was not a "person interested in the estate" and, therefore, does not show affirmatively that the document was presented for probate by a person not authorized by this section to do so. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

Death of Only Executor Named in Will before Testator. — Where the only executor named in the will has died before the testator, this section does not require another person "interested in the estate" to wait 60 days before applying to the clerk for the probate of the will. In re Estate of Davis, 277 N.C. 134, 176 S.E.2d 825 (1970).

Notice to Executor in Probating a Codicil. — Where an executor has probated and qualified under the will, it is equally necessary to give the statutory notice before offering for probate a separate paper-writing as a codicil. Spencer v. Spencer, 163 N.C. 83, 79 S.E. 291 (1913).

Presenting for Probate Merely to Secure Adjudication of Invalidity. — This section permits a person interested in the estate of a supposed testator to present an alleged will for probate merely for the purpose of obtaining an adjudication of its invalidity. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950); In re Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

This section empowers any person interested in the estate of a decedent to make application to have a script purporting to be the will of such decedent "proved," i.e., tested in respect to its validity as a testamentary instrument. It is obvious that the clause "any ... person interested in the estate" includes a person who will share in the estate under the law governing intestacy in case a script which purports to be the will of the deceased is adjudged invalid as a testamentary document. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950).

Cited in In re Brauff's Will, 247 N.C. 92, 100 S.E.2d 254 (1957); In re Pendergrass' Will, 251 N.C. 737, 112 S.E.2d 562 (1960); In re Will of Covington, 252 N.C. 551, 114 S.E.2d 261 (1960).

§ 31-14. Clerk to notify legatees and devisees of probate of wills.

The clerks of the superior court of the State are hereby required and directed to notify by mail, all legatees and devisees whose addresses are known, designated in wills filed for probate in their respective counties. All expense incident to such notification shall be deemed a proper charge in the administration of the respective estates. (1933, c. 133.)

Legal Periodicals. — For comment on section, see 11 N.C.L. Rev. 263 (1933).

§ 31-15. Clerk may compel production of will.

Every clerk of the superior court having jurisdiction, on application by affidavit setting forth the facts, shall, by summons, compel any person in the State, having in possession the last will of any decedent, to exhibit the same in his court for probate; and whoever being duly summoned refuses, in contempt of the court, to produce such will, or (the same having been parted with by him) refuses to inform the court on oath where such will is, or in what manner he has disposed of it, shall, by order of the clerk of the superior court, be committed to the jail of the county, there to remain without bail till such will be produced or accounted for, and due submission made for the contempt. (C.C.P., s. 442; Code, s. 2154; Rev., s. 3124; C.S., s. 4141.)

Cross References. — As to larceny, concealment, or destruction of wills, see G.S. 14-77.

Legal Periodicals. — For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

CASE NOTES

It is the policy of the law that wills should be probated, and that the rights of the parties in cases of dispute should be openly arrived at according to the orderly process of law. In re Pendergrass' Will, 251 N.C. 737, 112 S.E.2d 562 (1960).

Enforcement of Right to Dispose of Property. — The legislature, when it granted the right to dispose of property at death, provided for the enforcement of that right under this section. In re Will of Covington, 252 N.C. 546, 114 S.E.2d 257 (1960).

Compelling Production of Fraudulently Withheld Will. — A petition before the clerk of the superior court alleging that the respondents were in possession of a later will than that probated in another county, and that the petitioner was withholding this will for fraudulent purposes, etc., is a proceeding under this section to compel the production of a will. Williams v. Bailey, 177 N.C. 37, 97 S.E. 721 (1919).

Issue of Wrong Venue No Excuse. — Where the clerk of the court of G county issued a notice to the respondent, who had the will of the deceased in his possession, to exhibit the same for probate, it was the duty of the respondent to obey the summons, and he could have raised in his answer the question of whether the will should be probated in G or L county. In re Scarborough's Will, 139 N.C. 423, 51 S.E. 931 (1905).

Impossibility to Comply with Order as Excuse. — An order of the clerk of the court of G county which adjudges the respondent guilty of contempt and that he be committed to jail, until such will was produced, was properly reversed on appeal where it appears that the respondent cannot comply with the condition upon which he might be discharged, because the clerk of L county now has custody of the will and has refused to surrender it to the respondent. In re Scarborough's Will, 139 N.C. 423, 51 S.E. 931 (1905).

Allowance of Reasonable Expenses. — Where the law imposes a duty upon a person, or group of persons, with respect to probating and establishing the validity of a will, in the performance of such duty, in good faith, reasonable expenses thereby incurred should be allowed and paid out of the fund or property which is the subject of the litigation. Wells v. Odum, 207 N.C. 226, 176 S.E. 563 (1934).

Scope of Proceedings on Attachment for Contempt. — In a proceeding to attach the respondent for contempt in not producing for probate a will, the question whether the will should be probated in G or L county is not presented and cannot be passed upon. In re Scarborough's Will, 139 N.C. 423, 51 S.E. 931 (1905).

Motion to Dismiss Proceedings. — Where a rule issued under this section in proceedings to compel the production of a will should be discharged, a motion by the respondents to dismiss the proceedings will be treated as a motion to discharge them. Williams v. Bailey, 177 N.C. 37, 97 S.E. 721 (1919).

Discharge of Respondents on Failure of Petitioners to Pursue Proceedings. — Where the respondents in proceedings to compel the production of a will appear before the clerk at the time set for the hearing, and in writing under oath fully deny the charges made, and the petitioners neither file reply, offer evidence, nor request an examination, no issues are raised requiring the matter to be transferred to the trial docket, and the rule against the respondents should be discharged at the petitioner's cost. Williams v. Bailey, 177 N.C. 37, 97 S.E. 721 (1919).

Applied in In re Estate of Moore, 292 N.C. 58, 231 S.E.2d 849 (1977).

§ 31-16. What shown on application for probate.

On application to the clerk of the superior court, he must ascertain by affidavit of the applicant —

(1) That such applicant is the executor, devisee or legatee named in the will, or is some other person interested in the estate, and how so interested.

(2) The value and nature of the testator's property, as near as can be ascertained.

(3) The names and residences of all parties entitled to the testator's property, if known, or that the same on diligent inquiry cannot be discovered; which of the parties in interest are minors, and whether with or without guardians, and the names and residences of such guardians, if known.

Such affidavit shall be recorded with the will and the certificate of probate thereof, if the same is admitted to probate. (C.C.P., s. 441; Code, s. 2153; Rev., s. 3125; C.S., s. 4142.)

CASE NOTES

Applied in In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

§ 31-17. Proof and examination in writing.

Every clerk of the superior court shall take in writing the proofs and examinations of the witnesses touching the execution of a will, and he shall embody the substance of such proofs and examinations, in case the will is admitted to probate, in his certificate of the probate thereof, which certificate must be recorded with the will. The proofs and examinations as taken must be filed in the office. (C.C.P., s. 437; Code, s. 2149; Rev., s. 3126; C.S., s. 4143.)

Legal Periodicals. — For comment on the necessity for proof of due execution of a will, see 3 Wake Forest Intra. L. Rev. 12 (1967).

CASE NOTES

Compliance with this section is essential to a valid probate. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Presumption of Valid Probate and Recordation. — The requirements of this section did not obtain in the probate of a will in the old practice before the court of pleas and quarter sessions; and where the records show that a will sought to be set aside for improper probate, valid on its face, has been transcribed upon the records of that court, it is presumed to have been duly admitted to probate and properly transcribed upon the record, the burden being upon the caveator to show to the contrary. Poplin v. Hatley, 170 N.C. 163, 86 S.E. 1028 (1915).

Conclusiveness of Certificate as to Validity. — Probate of a will by the clerk of the superior court is a judicial act, and his certificate is conclusive evidence of the validity of the will, until vacated on appeal, or declared void by a competent tribunal in a proceeding instituted for that purpose. It cannot be vacated in a collateral manner. Mayo v. Jones, 78 N.C. 402 (1878); McClure v. Spivey, 123 N.C. 678, 31 S.E. 857 (1898).

Testimony of Witnesses Must Be Embodied in Clerk's Certificate. — It is the duty of the clerk taking probate of a will to embody the substance of the testimony of witnesses in his certificate of probate to be recorded with the will. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Foreign Records Conforming to Section Sufficient. — Where a nonresident testator devises land in this State, and the record of the foreign court of probate, duly certified, contains the certificate of probate, which refers to the certified examinations of the witnesses, in accordance with the requirements of this section, the whole forming one transaction, the exemplification of which and of the will being duly recorded in the county where the land lies, the will is sufficiently proved and passes the property. Roscoe v. John L. Roper Lumber Co., 124 N.C. 42, 32 S.E. 389 (1899).

Former Practice. — Formerly the court of pleas and quarter sessions had jurisdiction of the probate of wills, and there was at that time no provision in the statute requiring the taking of the proofs in writing or for recording the probate. The practice was to exhibit the will before the court and offer the proofs of execution, and for an entry to be made upon the minutes of the adjudication, and the clerk, acting upon the authority of the court, then recorded the will upon the will book. In most instances he also recorded a memorandum of the proceedings before the court, but this was not done in all cases. Poplin v. Hatley, 170 N.C. 163, 86 S.E. 1028 (1915).

Applied in In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

Cited in Carter v. Marion, — N.C. App. —, 645 S.E.2d 129, 2007 N.C. App. LEXIS 1089 (2007).

§ 31-18: Rewritten and renumbered as G.S. 31-18.1 to 31-18.3 by Session Laws 1953, c. 1098, s. 12.

§ 31-18.1. Manner of probate of attested written will.

(a) An attested written will, executed as provided by G.S. 31-3.3, may be probated in the following manner:

(1) Upon the testimony of at least two of the attesting witnesses; or

(2) If the testimony of only one attesting witness is available, then

a. Upon the testimony of such witness, and

  b. Upon proof of the handwriting of at least one of the attesting witnesses who is dead or whose testimony is otherwise unavailable, and
  c. Upon proof of the handwriting of the testator, unless he signed by his mark, and
  d. Upon proof of such other circumstances as will satisfy the clerk of the superior court as to the genuineness and due execution of the will; or

(3) If the testimony of none of the attesting witnesses is available, then
  a. Upon proof of the handwriting of at least two of the attesting witnesses whose testimony is unavailable, and
  b. Upon compliance with paragraphs c and d of subsection (a)(2) of this section; or

(4) Upon a showing that the will has been made self-proved in accordance with the provisions of G.S. 31-11.6.

(b) Due execution of a will may be established, where the evidence required by subsection (a) is unavoidably lacking or inadequate, by testimony of other competent witnesses as to the requisite facts.

(c) The testimony of a witness is unavailable within the meaning of this section when the witness is dead, out of the State, not to be found within the State, insane or otherwise incompetent, physically unable to testify or refuses to testify. (1953, c. 1098, s. 12; 1977, c. 795, s. 2; 1979, c. 107, s. 4.)

Legal Periodicals. — For note as to procedure in probating will when witnesses are dead, see 35 N.C.L. Rev. 341 (1957).

For comment on the necessity for proof of due execution of a will, see 3 Wake Forest Intra. L. Rev. 12 (1967).

For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For survey of 1979 property law, see 58 N.C.L. Rev. 1509 (1980).

CASE NOTES

Editor's Note. — *Many of the cases cited below construe former G.S. 31-18.*

Compliance with Statute Required. — In order that a paper-writing, designed as a testamentary disposition of property, may effectuate this purpose it must have been executed and proven in strict compliance with the statutory requirements. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948). See Wescott v. First & Citizens Nat'l Bank, 227 N.C. 39, 40 S.E.2d 461 (1946). See also Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956).

Evidence Must Show Subscribing in Presence of Testator. — Under G.S. 31-3.3 and this section, it is essential, not only that the document shall be subscribed in the presence of the testator by at least two witnesses, but that the evidence upon which the will is admitted to probate must show that fact. In re Thomas, 111 N.C. 409, 16 S.E. 226 (1892).

Proof Required When Only One Witness Available. — An attested will may be probated on the testimony of two of the attesting witnesses, but if the testimony of only one attesting witness is available, then upon the testimony of such witness with proof of the handwriting of at least one of the attesting witnesses who is dead or whose testimony is otherwise unavailable, and proof of the handwriting of the testator, unless he signed by his mark, and proof of such other circumstances as will satisfy the clerk of the superior court as to the genuineness and due execution of the will. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

The statute seems to require that, when the will purports to be signed by the testator himself and only one of the subscribing witnesses is alive and competent, some evidence should be introduced as to the handwriting of the testator or the genuineness of the signature. Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913).

It is not required, in order to have a valid probate, that the surviving witness should testify that he saw the other witness subscribe his name to the instrument. Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913).

For a will to be admitted to probate, subdivision (a)(1) of this section requires that the will meet the requirements of G.S. 31-3.3 and that two of the attesting witnesses testify before the court. In re Will of Everhart, 88 N.C. App. 572, 364 S.E.2d 173, cert. denied, 322 N.C. 112, 367 S.E.2d 910 (1988).

No Requirement That Witness Be Able to See Will. — Subdivision (a)(1) of this section requires only that an attested will be probated "upon the testimony of at least two of the attesting witnesses." It does not require that the witness be able to see the will and the signatures on it at the time of the caveat proceeding in order that he may give testimony to prove it. In re Will of Weston, 38 N.C. App. 564, 248 S.E.2d 359 (1978).

A witness who had become blind by the time of the caveat proceeding, but who had full use of his ocular capacity at the time the testator executed the document and at the time it was probated in common form did not come within any of the definitions of "unavailable" in subsection (c) of this section. In re Will of Weston, 38 N.C. App. 564, 248 S.E.2d 359 (1978).

Whether or not the witness by virtue of his blindness at the time of the caveat proceeding was "unavailable," was a question of law to be decided by the judge. In re Will of Weston, 38 N.C. App. 564, 248 S.E.2d 359 (1978).

Proof De Novo on Issue of Devisavit Vel Non. — The authorities seem to hold that in the trial of an issue of devisavit vel non, on caveat duly entered, the proof as to the formal execution of the will shall be made de novo. Watson v. Hinson, 162 N.C. 72, 77 S.E. 1089 (1913), citing In re Hedgepeth's Will, 150 N.C. 245, 63 S.E. 1025 (1909).

Applied in In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

Cited in In re Will of Thompson, 196 N.C. 271, 145 S.E. 393 (1928); In re Will of Shemwell, 197 N.C. 332, 148 S.E. 469 (1929); In re Will of Stewart, 198 N.C. 577, 152 S.E. 685 (1930); In re Will of Lowrance, 199 N.C. 782, 155 S.E. 876 (1930); Cartwright v. Jones, 215 N.C. 108, 1 S.E.2d 359 (1939); McMillan v. Robeson, 225 N.C. 754, 36 S.E.2d 235 (1945); Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968).

§ 31-18.2. Manner of probate of holographic will.

A holographic will may be probated only in the following manner:

(1) Upon the testimony of at least three competent witnesses that they believe that the will is written entirely in the handwriting of the person whose will it purports to be, and that the name of the testator as written in or on, or subscribed to, the will is in the handwriting of the person whose will it purports to be; and

(2) Upon the testimony of one witness who may, but need not be, one of the witnesses referred to in subdivision (1) of this section to a statement of facts showing that the will was found after the testator's death as required by G.S. 31-3.4. (1953, c. 1098, s. 12.)

Cross References. — As to requirements for valid holographic will, see G.S. 31-3.4.

CASE NOTES

Indicia of Holographic Will Held Sufficient. — Where caveators presented testimony that holographic writings were found among papers which included the titles to testator's car and housetrailer, copies of property deeds, health insurance papers, and cancelled bank notes, further testimony that testator duly executed his signature on the writings before a notary public, and the testimony of three witnesses who testified they were familiar with both the handwriting and signature of the testator and that they believed the subject writings and signatures to be in testator's own hand, caveators presented sufficient indicia of a holographic will under section 31-3.4 and they satisfied the requirements of this section; therefore, propounders' motion for directed verdict was properly denied. In re Will of Penley, 95 N.C. App. 655, 383 S.E.2d 385, cert. denied, 326 N.C. 48, 389 S.E.2d 93 (1990).

Engraved Monogram of Testatrix Not Construed as Signature. — An engraved monogram of a testatrix, appearing on the instrument offered for probate in solemn form as a holographic will, may not be considered as a part thereof. The monogram is not in her handwriting and may not be construed to be her signature. Pounds v. Litaker, 235 N.C. 746, 71 S.E.2d 39 (1952).

This section requires twofold testimony from three witnesses concerning handwriting of the purported testator: (1) That the will is written entirely in his handwriting, and (2) that his name appearing in or on, or subscribed to, the will is in his handwriting. In re Will of Loftin, 24 N.C. App. 435, 210 S.E.2d 897, cert. denied, 286 N.C. 545, 212 S.E.2d 169 (1975).

When Witness Is Competent to Give Opinion. — When a witness swears that he is "well acquainted" with a decedent's handwriting, and is not asked on cross-examination how he became familiar with it, he is prima facie competent. In re Will of Loftin, 24 N.C. App. 435, 210 S.E.2d 897, cert. denied, 286 N.C. 545, 212 S.E.2d 169 (1975).

Where a witness was not asked, and he did not testify, whether he had acquired knowledge of decedent's handwriting or whether he was familiar with it, the witness was not competent to give an opinion as to handwriting, and his testimony did not satisfy the statutory requirements. In re Will of Loftin, 24 N.C. App. 435, 210 S.E.2d 897, cert. denied, 286 N.C. 545, 212 S.E.2d 169 (1975).

Presumption of Competency Rebutted. — See In re Will of Loftin, 24 N.C. App. 435, 210 S.E.2d 897, cert. denied, 286 N.C. 545, 212 S.E.2d 169 (1975).

Handwriting Goes to Jury on Testimony of Three Witnesses. — Testimony of three witnesses that the paper-writing propounded as the holographic will of decedent was in his handwriting takes the case to the jury as to this requirement, notwithstanding conflicting testimony of caveator. In re Williams' Will, 215 N.C. 259, 1 S.E.2d 857 (1939).

In an action to probate a destroyed holographic will, the propounder must show that the instrument in the handwriting of the deceased and signed by him once existed and was destroyed under circumstances that would defeat an inference of revocation. Upon failure of such proof, there is a failure of the proof of the res and a nonsuit is proper. Hewett v. Murray, 218 N.C. 569, 11 S.E.2d 867 (1940).

Applied in McEwan v. Brown, 176 N.C. 249, 97 S.E. 20 (1918); Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956).

Cited in Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968); In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

§ 31-18.3. Manner of probate of nuncupative will.

(a) No nuncupative will may be probated later than six months from the time it was made unless it was reduced to writing within 10 days after it was made.

(b) Before a nuncupative will may be probated

- (1) Written notice must be given to the surviving spouse, if any, and to the next of kin, by the clerk of the court in which it is to be probated, notifying them that the will has been offered for probate and that they may, if they desire, oppose the probate thereof, or
- (2) When the surviving spouse or next of kin are not known or when for any other reason such notice cannot be given, a notice to the same effect must be published not less than once a week for four consecutive weeks in some newspaper published in the county where the will is offered for probate, or if no newspaper is published in the county, then in some newspaper having general circulation therein.

(c) A nuncupative will may be probated only in the following manner:

- (1) Upon the testimony of at least two competent witnesses who establish the terms of such will and who state that they were simultaneously present at the making thereof, that the testator declared he was then making his will, and that they were then and there specially requested by him to bear witness thereto; and
- (2) Upon the testimony of one competent witness, who may but need not be one of the witnesses referred to in subdivision (1) of this subsection, that the will was made in the testator's last illness or while he was in imminent peril of death, and that he did not survive such sickness or imminent peril, but it is not necessary that all such facts be proved by the testimony of the same witness. (1953, c. 1098, s. 12.)

Cross References. — As to requirements for valid nuncupative will, see G.S. 31-3.5.

Legal Periodicals. — For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

CASE NOTES

Editor's Note. *— The cases cited below construe the provisions of former G.S. 31-18 which related to nuncupative wills.*

Similarity to English Statute of Frauds. — Statutory provisions in relation to nuncupative wills have existed in this State since 1784, and they originally were substantially the same as those in the English Statute of Frauds, 29 Car. II, ch. 3, G.S. 19, 20. These provisions have always been strictly construed and enforced by the courts, both in this State and in England. Smith v. Smith, 63 N.C. 637 (1869).

The purpose of the statute is not to prevent the examination of the witnesses of the will, after such lapse of six months, on the trial of the issue devisavit vel non in the course of a contest of it, but it is to require that they shall not be allowed to prove it in the first instance, when it is first presented for probate after that time, unless it shall have been put in writing within 10 days next after the making thereof. In re Haygood's Will, 101 N.C. 574, 8 S.E. 222 (1888).

Strict Compliance Necessary. — The requisites of this statutory provision must be strictly complied with and observed, in all material respects, in order to prevent opportunity for fraudulent practices on the part of such persons as would be disposed to obtain undue advantage of persons in their last sickness as to the final disposition of their property; and also to prevent mischiefs that might arise from the ignorance, misapprehension or dishonest purposes of persons called upon to be the witnesses of such wills. The purpose of such requisites is to prevent the fabrication of such wills; they are necessary, and it is essential to observe them strictly. Brown v. Brown, 6 N.C. 350 (1818); Rankin v. Rankin, 31 N.C. 156 (1848); Webster v. Webster, 50 N.C. 95 (1857); Haden v. Bradshaw, 60 N.C. 259 (1864); Smith v. Smith, 63 N.C. 637 (1869); Bundrick v. Haygood, 106 N.C. 468, 11 S.E. 423 (1890); Long v. Foust, 109 N.C. 114, 13 S.E. 889 (1891).

The testator must state his wishes in the presence of two witnesses and specially require them to bear witness thereto in order to constitute a valid nuncupative will. Kennedy v. Douglas, 151 N.C. 336, 66 S.E. 216 (1909).

Where a woman in her last illness, without expressing any purpose to make a will said she wanted to give to her sister certain articles of personal property, and called her to her bedside and gave them to her, in the presence of two other persons but did not call them, or either of them, to witness the transaction, it was held that this did not constitute a nuncupative will. Bundrick v. Haygood, 106 N.C. 468, 11 S.E. 423 (1890).

Designation of Witnesses by Name Not Necessary. — It is sufficient that the testator saw the witnesses and charged them to bear witness to his will, and they did so, and it is not a good objection that he failed to designate them particularly by name. That he required them, each, all of them, to bear witness, was what the section requires. The purpose is that the testator shall require two witnesses at least to take notice and bear witness that he makes his will. He must require and direct a competent person, and that person must be able to testify that he was one of the persons — the witnesses — so required, and that he did take notice and bear witness. Long v. Foust, 109 N.C. 114, 13 S.E. 889 (1891).

Sufficiency of Showing. — Under this section, it is sufficient to show, on the question of the testator's requesting that the witness "bear witness" to the will, that believing himself to be in extremis, he told the witness during his last illness that he wanted to make a will, who, at his request, called in another and while they were at his bedside, testator gave specific directions for the disposition of his personal property; and though he had therefore expressed his wish to make a written will, and had failed in his effort to do so, the matters sought to be established as the nuncupative will were declared at a time when he was apprehensive that he would become unable to talk, and about four days before his death. In re Garland's Will, 160 N.C. 555, 76 S.E. 486 (1912).

Where a person, being in extremis, and conscious of it, sent for a friend with whom he had often talked on the subject of a will and told him what disposition he wanted to make of his property, and then such friend replied that if he wanted to do anything of that kind he had better have some other person in the room, and thereupon the speaker went out and brought in another person, and in the presence of the sick man repeated the proposed disposition of the property, to which the latter assented, it was held, to be a sufficient rogatio testium to satisfy the requirements of a nuncupative will. Smith v. Smith, 63 N.C. 637 (1869).

Citation or Publication Within Limitation of Six Months. — After the contents of the will are established within the time and in the manner prescribed by this section it cannot be admitted to probate until the citation or publication, and the probate based thereon shall be completed within six months from the making of the alleged will. The limitation of six months refers only to the proof and establishment of the contents, and that only where it is not reduced to writing within 10 days of its making. In re Haygood's Will, 101 N.C. 574, 8 S.E. 222 (1888).

Will Not to Be Proved until Citation Made. — It will be observed that it is not required that the will shall not be proved by the witnesses until the citation and notice provided for shall be made, but it shall not be proved — that is, proved in the sense of admitting it to probate at once — until citation shall be made, the purpose being to give the widow and next of kin opportunity to contest the will — the proof thereof by the witnesses thereof — if they shall see fit to do so. In re Haygood's Will, 101 N.C. 574, 8 S.E. 222 (1888).

Will Reduced to Writing May Be Proved Before or After Six Months. — A just interpretation of the provision relative to the proof of a nuncupative will is, that if such will shall be put in writing within 10 days next after it was made, it may be proved by the witnesses thereof either before or after the lapse of six months next after the making thereof, because the will being in writing with the sanction of the witnesses, their recollection so as to what it was is helped and strengthened thereby, and they could the better be trusted to testify as to the making of the same, and what it was in its detail, at any time within a reasonable period. In re Haygood's Will, 101 N.C. 574, 8 S.E. 222 (1888).

Writing Dictated to One Witness but Execution Postponed. — A paper-writing which the deceased had therefore dictated but postponed executing from time to time and which he finally declared to be his will without reading it, at a time he was in his last sickness not expecting to recover and physically unable to execute it, is invalid as a nuncupative will: (1) His intent that it should be a written will is evidenced by his conduct; (2) the dictation was not in law "during his last sickness." Kennedy v. Douglas, 151 N.C. 336, 66 S.E. 216 (1909).

The declaration of a testator made in the presence of two witnesses that a paper-writing contained the disposition he desired made of his property and that he desired its provisions carried out, without reading or having the paper read at the time, but relying upon the assertion of a person then present that it contained his wishes as dictated by him several months before, is invalid as a nuncupative will: (1) The dictation was made to one witness alone; (2) there was no sufficient declaration then and there of the testator's wishes in the presence of two witnesses from which they could reduce their recollection to writing within 10 days. Kennedy v. Douglas, 151 N.C. 336, 66 S.E. 216 (1909).

§ 31-18.4. Probate of wills of members of the armed forces.

In addition to the methods already provided in existing statutes therefor, a will executed by a person while in the armed forces of the United States or the merchant marine, shall be admitted to probate (whether there were subscribing witnesses thereto or not, if they, or either of them, is out of the State at the time said will is offered for probate) upon the oath of at least three credible witnesses that the signature to said will is in the handwriting of the person whose will it purports to be. Such will so proven shall be effective to devise real property as well as to bequeath personal estate of all kinds. This section shall not apply to cases pending in courts and at issue on the date of its ratification. (1919, c. 216; C.S., s. 4151; Ex. Sess. 1921, c. 39; 1943, c. 218; 1945, c. 81; 1953, c. 1098, s. 13.)

§ 31-19. Probate conclusive until vacated; substitution of consolidated bank as executor or trustee under will.

Such record and probate is conclusive in evidence of the validity of the will, until it is vacated on appeal or declared void by a competent tribunal. Provided, that whenever in a will so probated or recorded a bank or trust company shall be named executor and/or trustee and shall have at the time of such probate and recording become absorbed by or consolidated with another bank or trust company or shall have sold and transferred all its assets and liabilities to another bank or trust company doing business in North Carolina, such latter bank or trust company shall be deemed substituted for and shall have all the rights and powers of the former bank or trust company. (C.C.P., s. 438; Code, s. 2150; Rev., s. 3128; C.S., s. 4145; 1929, c. 150; 1941, c. 79.)

CASE NOTES

This section is restricted to a decree of probate regular on its face, and does not apply where on the face of the decree of probate it affirmatively shows that the will was not probated as required by mandatory applicable statutes for the probate of wills. Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956); Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968).

Probated will constitutes a muniment of title unassailable except in a direct proceeding. Whitehurst v. Abbott, 225 N.C. 1, 33 S.E.2d 129 (1945); In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948); Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965).

Under this section a will probated and recorded in accordance with the applicable statute constitutes a muniment of title. Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968).

Conclusively Valid Until Declared Void. — When executed, proven and recorded in manner and form as prescribed, a paper-writing designed as a testamentary disposition of property is given conclusive legal effect as the last will and testament of the decedent, subject only to be vacated on appeal or declared void by a court of competent jurisdiction in a proceeding instituted for that purpose. Until so set aside it is presumed to be the will of the testator. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948).

Probate of a will by the clerk of the superior court is a judicial act, and his certificate is conclusive evidence of the validity of the will, until vacated on appeal, or declared void by a competent tribunal in a proceeding instituted for that purpose. It cannot be vacated in a collateral manner. Mayo v. Jones, 78 N.C. 402 (1878); McClure v. Spivey, 123 N.C. 678, 31 S.E. 857 (1898).

A will probated in common form before the clerk of the superior court is conclusively valid until declared void by a competent tribunal, and may be offered in evidence in proceedings to caveat the will. Holt v. Ziglar, 163 N.C. 390, 79 S.E. 805 (1913). See In re Beauchamp's Will, 146 N.C. 254, 59 S.E. 687 (1907).

Under this section the order of the clerk admitting a paper-writing to probate constitutes conclusive evidence that the paper-writing is the valid will of the decedent until it is declared void by a competent tribunal on an issue of devisavit vel non in a caveat proceeding. Holt v. Holt, 232 N.C. 497, 61 S.E.2d 448 (1950); Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965); Johnson v. Stevenson, 269 N.C. 200, 152 S.E.2d 214 (1967).

Once a paper-writing has been probated as a will, every part of it stands until set aside by the appropriate tribunal. Ravenel v. Shipman, 271 N.C. 193, 155 S.E.2d 484 (1967).

Where the clerk of the superior court probates a will in common form and records it properly, the record and probate are conclusive as to the validity of the will until vacated on appeal or declared void by a competent tribunal. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Until set aside in a direct attack, a will is conclusively presumed to be the will of the testator. In re Will of Cooper, 196 N.C. 418, 145 S.E. 782 (1928).

Cannot Be Attacked Collaterally. — Where a will has been admitted to probate a party claiming property disposed of by it to another cannot, in an action to recover the same, be permitted to attack the will on the ground of the lack of testamentary capacity of the testatrix, and evidence offered for that purpose is properly excluded. Varner v. Johnston, 112 N.C. 570, 17 S.E. 483 (1893).

A will probated in common form is not subject to collateral attack, but is binding or conclusive until set aside in a direct proceeding. Mills v. Mills, 195 N.C. 595, 143 S.E. 130 (1928).

Under this section, a will probated and recorded in accordance with the applicable statute may not be collaterally attacked. Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968).

Same — Even for Fraud. — A will which has been duly probated in common form may not be collaterally attacked even for fraud. Crowell v. Bradsher, 203 N.C. 492, 166 S.E. 331 (1932).

The probate of a will in common form is conclusive as to the validity of the instrument until set aside in a caveat proceeding duly instituted, and while the beneficiaries under the will may be held trustees ex maleficio for extrinsic fraud which interferes with the right to caveat the instrument, the probate may not be collaterally attacked for intrinsic fraud constituting grounds for attack of the instrument by caveat proceedings when there is nothing to show that plaintiff's right to attack by caveat was interfered with in any manner. Johnson v. Stevenson, 269 N.C. 200, 152 S.E.2d 214 (1967).

Same — Offer of Subsequent Will. — Where a paper-writing has been duly probated in common form, offer of proof of a will alleged to have been subsequently executed by the testatrix is a collateral attack, and the clerk is without jurisdiction to set aside the probate upon such proof. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948).

An order of the clerk adjudging a will to be fully proved in common form is not "conclusive in evidence of the validity of the will" under this section, on the issue of devisavit vel non, raised by a caveat filed thereto. Wells v. Odum, 205 N.C. 110, 170 S.E. 145 (1933); In re Will of Etheridge, 231 N.C. 502, 57 S.E.2d 768 (1950).

Clerk May Revoke Probate. — Where the clerk of the superior court has probated as a will a document which has not been executed in accordance with the statutory requirements for probate or which shows on its face that it was not intended as a testamentary disposition of the author's property, or when other jurisdictional requirements for probate are shown to be lacking, the clerk may revoke his probate. Ravenel v. Shipman, 271 N.C. 193, 155 S.E.2d 484 (1967).

The probate of a will may be set aside upon motion after notice where it is clearly made to appear that the court was imposed upon or misled, but otherwise the probate is conclusive and cannot be collaterally attacked, and the paper-writing stands as the last will and testament until declared void in a direct proceeding in the nature of a caveat under G.S. 31-32. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948).

Clerk May Not Set Aside Probate on Grounds Determinable by Caveat. — While the clerk of the superior court in proper instances may set aside a probate in common form, he may not do so on grounds which are properly determinable by caveat. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

The burden of proof on a motion to vacate a probate is on the movants to establish sufficient grounds to set aside the probate. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Effect of Order of Clerk. — An order of the clerk adjudging paper-writing to be fully proved in common form is not "conclusive in evidence of the validity of the will," under this section, on the issue of devisavit vel non, but as between the probated instrument and the prior purported wills, the former stands until "declared void by a competent tribunal." In re Neal's Will, 227 N.C. 136, 41 S.E.2d 90 (1947).

Rents and profits of lands devised belonged to beneficiaries and their ancestors until the probate was set aside and the will adjudged void. Hinton v. Whitehurst, 214 N.C. 99, 198 S.E. 579 (1938).

When Devisees Entitled to Rents and Profits until Probate Set Aside. — Where there is no evidence tending to show that at any time prior to the institution of the caveat proceeding, the defendants, or their ancestors, had any knowledge or intimation that the plaintiffs would attack the validity of the will and there is no evidence tending to show that any of the devisees in said will procured its execution by undue or fraudulent influence, the defendants and their ancestors were entitled to the rents and profits of the lands devised to them until the probate was set aside and the will adjudged void. Whitehurst v. Hinton, 209 N.C. 392, 184 S.E. 66 (1936).

Effect of Revocation of Probate upon Administration. — The revocation of the probate in common form did not have the effect of annulling the administration properly granted. Floyd v. Herring, 64 N.C. 409 (1870).

Title of Innocent Purchasers Not Affected by Judgment Setting Aside Will. — Where the devisees named in a will, which has been duly probated in common form, sell and dispose of part of the lands devised to innocent purchasers for value without notice, and thereafter caveat proceedings are instituted and the will set aside, the heirs at law, by operation of the judgment setting aside the will, become tenants in common in the lands not disposed of, but the title conveyed by the devisees named in the paper-writing to purchasers for value without notice, or knowledge of facts from which a purpose to file caveat proceedings could be intimated, is not affected, the probate in common form being conclusive evidence of the validity of the will until it is attacked by caveat proceedings duly instituted. Whitehurst v. Hinton, 209 N.C. 392, 184 S.E. 66 (1936).

Inadequacy of Relief Through Caveat Proceeding Entitled Decedent's Step-grandchildren to Proceed on Tort Claim. — Superior court erroneously dismissed a claim filed by two of decedent's step-grandchildren that defendants, two of the decedent's other step-grandchildren, maliciously caused their step-grandmother to execute a will that left them only nominal bequests, as: (1) the movant step-grandchildren would not be able to obtain adequate relief through a caveat proceeding; and (2) it did not appear that the step-grandchildren could not prove a set of facts supporting their claim which would entitle them to relief. Murrow v. Henson, 172 N.C. App. 792, 616 S.E.2d 664, 2005 N.C. App. LEXIS 1809 (2005).

Cited in Bueltel v. Lumber Mut. Ins. Co., 134 N.C. App. 626, 518 S.E.2d 205, 1999 N.C. App. LEXIS 865 (1999), cert. denied, 351 N.C. 186, 541 S.E.2d 709 (1999).

§ 31-20. Wills filed in clerk's office.

All original wills shall remain in the clerk's office, among the records of the court where the same shall be proved, and to such wills any person may have access, as to the other records. If said will contains a devise of real estate, outside said county where said will is probated, then a copy of the said will, together with the probate of the same, certified under the hand and seal of the clerk of the superior court of said county may be recorded in the book of wills and filed in the office of the clerk of the superior court of any county in the State in which said land is situated with the same effect as to passing the title to said real estate as if said will had originally been probated and filed in said county and the clerk of the superior court of said last-mentioned county had had jurisdiction to probate the same. (1777, c. 115, s. 59; R.C., c. 119, s. 19; Code, s. 2173; Rev., s. 3129; 1921, c. 108, s. 1; C.S., s. 4146.)

Cross References. — As to recordation in county where land lies, see G.S. 31-39.

CASE NOTES

Will Taken from Record as Evidence of Testator's Handwriting. — An original will taken from the records of the court is competent, without further proof of its execution, as a basis of comparison in determining the genuineness of the handwriting of testator to the instrument in controversy. Croom v. Sugg, 110 N.C. 259, 14 S.E. 748 (1892).

Cited in Haw River Land & Timber v. Lawyers Title Ins., 152 F.3d 275 (4th Cir. 1998).

§ 31-21. Validation of wills heretofore certified and recorded.

All wills which have prior to March 9, 1921, been certified and recorded in the office of the clerk of the superior court of any county, substantially following the provisions of G.S. 31-20 are hereby validated and approved as to the conveyance and transfer of any title to real estate as contained therein, to the same extent as if said wills had originally been probated and filed in said county, and the clerk of the superior court of said county had had jurisdiction to probate the same, provided the probates and witnesses to the said wills are sufficient and according to law. (1921, c. 108, s. 2; C.S., s. 4146(a).)

CASE NOTES

Statute Not Retroactive. — Public Laws 1921, c. 108 (G.S. 31-20 and this section), does not control rights which accrued prior to its enactment. Hence, when an original will probated in 1910 is invalidated by judicial decree, a certified copy thereof recorded in another county becomes void and one who purchases with notice of the caveat cannot convey any title thereunder, either before or after notice of its invalidity has been filed in the county where the certified copy has been recorded. The only purpose of such certified copy was to give notice of the source of title. Whitehurst v. Abbott, 225 N.C. 1, 33 S.E.2d 129 (1945).

§ 31-22. Certified copy of will proved in another state or country.

When a will, made by a citizen of this State, is proved and allowed in some other state or country, and the original will cannot be removed from its place of legal deposit in such other state or country, for probate in this State, the clerk of the superior court of the county where the testator had his last usual residence or has any property, upon a duly certified copy or exemplification of such will being exhibited to him for probate, shall take every order and proceeding for proving, allowing and recording such copy as by law might be taken upon the production of the original. (1802, c. 623; R.C., c. 44, s. 9; C.C.P., s. 445; Code, s. 2157; Rev., s. 3130; C.S., s. 4147.)

CASE NOTES

When a resident of this State dies outside the State and his will is probated in another state, a duly certified copy of the will so probated may be offered for original probate in this State, and its validity as a testamentary disposition of property established in the same manner as if the original had been offered for probate here. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Defective Certificate of Clerk. — The certificate of probate of a will executed in another state, disposing of real estate in this State, is defective where it does not show affirmatively that the will was executed according to the laws of this State. Raleigh & W. Ry. v. Glendon & Gulf Mining & Mfg. Co., 113 N.C. 241, 18 S.E. 208 (1893).

Applied in In re Brauff's Will, 247 N.C. 92, 100 S.E.2d 254 (1957).

Cited in In re Will of Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

§ 31-23: Repealed by Session Laws 1987, c. 78, s. 1.

§ 31-24. Examination of witnesses by affidavit.

(a) The examination of witnesses to a will may be taken and subscribed in the form of an affidavit before a notary public or other person who is authorized to administer oaths in the jurisdiction where the examination is held.

(b) A photographic copy of the original will certified to be a true and exact copy thereof by the clerk of superior court of the county in which the will is to be probated may be used in the examination of the witnesses in the procedures set out in subsection (a); provided, the said clerk has in his possession the original will at the time of examination of the witnesses.

(c) Affidavits taken in accordance with subsection (a) shall be transmitted by the person taking the affidavit to the clerk of superior court of the county in which the will is to be probated.

(d) Testimony submitted in accordance with subsection (a) is competent in regard to all requirements of G.S. 31-3.3 and to establish that a will was executed in compliance with the requirements of G.S. 31-3.3.

(e) Nothing in this section is to limit or otherwise affect the authority of a clerk of superior court in the exercise of his authority as judge of probate under G.S. 28A-2-1 to:

(1) Issue subpoenas under G.S. 7A-103; or
(2) Order the taking of depositions of witnesses. (1917, c. 183; C.S., s. 4149; 1933, c. 114; 1957, c. 587, ss. 1, 1A; 1979, c. 226, s. 1; 1987, c. 78, s. 2.)

Legal Periodicals. — As to 1933 amendment, see 11 N.C.L. Rev. 262 (1933).

§§ 31-25, 31-25.1: Repealed by Session Laws 1987, c. 78, s. 1.

§ 31-26: Renumbered as G.S. 31-18.4 by Session Laws 1953, c. 1098, s. 13.

§ 31-27. Certified copy of will of nonresident recorded.

(a) Subject to the provisions of subsection (b), if the will of a citizen or subject of another state or country is probated in accordance with the laws of that jurisdiction and a duly certified copy of the will and the probate proceedings are produced before a clerk of superior court of any county wherein the testator had property, the copy of the will shall be probated as if it were the original. If the jurisdiction is within the United States, the copy of the will and the probate proceedings shall be certified by the clerk of the court wherein the will was probated. If the jurisdiction is outside the United States, the copy of the will and probate proceedings shall be certified by any ambassador, minister, consul or commercial agent of the United States under his official seal.

(b) For a copy of a will probated under the provisions of subsection (a) to be valid to pass title to or otherwise dispose of real estate in this State, the execution of said will according to the laws of this State must appear affirmatively, to the satisfaction of the clerk of the superior court of the county in which such will is offered for probate, from the testimony of a witness or witnesses to such will, or from findings of fact or recitals in the order of probate, or otherwise in such certified copy of the will and probate proceedings.

(c) If the execution of the will in accordance with the laws of this State does not appear as required by subsection (b), the clerk before whom the copy is exhibited shall have power to take proof as prescribed in G.S. 31-24, and the will may be adjudged duly proved, and if so proved, the will shall be recorded as herein provided.

(d) Any copy of a will of a nonresident heretofore allowed, filed and recorded in this State in compliance with the foregoing shall be valid to pass title to or otherwise dispose of real estate in this State. (C.C.P., s. 444; 1883, c. 144; Code, s. 2156; 1885, c. 393; Rev., s. 3133; C.S., s. 4152; 1941, c. 381; 1965, c. 995; 1987, c. 78, s. 3.)

Legal Periodicals. — For comment on the 1941 amendment, see 19 N.C.L. Rev. 547 (1941).

CASE NOTES

Probate on Exemplified Copy of Will and Foreign Probate Proceedings — Effect. — Instead of offering a will of a nonresident dying outside the State and disposing of property in the State for original probate in this State, the interested parties may have it probated in the state in which the testator was domiciled. When probated according to the laws of that state, an exemplified copy of the will and the probate proceedings may be brought to this State and probated here. Such a will, unless probated in accordance with the laws of this State, is not sufficient to dispose of real property in this State. It has no efficacy for any purpose in this State until probated here, but when probated here on the exemplified copy, it suffices to pass title to personalty and the right to enforce claims which testator could assert against citizens or properties in this State, even though not executed or proven as required by the laws of this State. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Orderly Arrangement of Pages of Exemplification. — Where the will has been admitted to probate in the court having jurisdiction to admit wills and testaments to probate, even though the pages of the manuscript exemplified copy are not orderly arranged, the will will be admitted to probate and record in this State, under the provisions of this section. Roscoe v. John L. Roper Lumber Co., 124 N.C. 42, 32 S.E. 389 (1899); John L. Roper Lumber Co. v. Hudson, 153 N.C. 96, 68 S.E. 1065 (1910).

Authentication by Clerk of Court and Not Register of Deeds. — It is necessary to the registration of a copy of a will in this State that the copy or exemplification of the will be duly certified and authenticated by the clerk of the court in which it has been proved or allowed, and if it has been allowed to be registered here under the certificate and seal of the register of deeds in another state it is ineffectual as evidence in a claimant's chain of title. Riley v. Carter, 158 N.C. 484, 74 S.E. 463 (1912).

Appearance and Examination of Attesting Witness Not Necessary. — Under the provisions of this section, it is not required that a will executed and admitted to probate in another state be also probated in this State by the appearance and examination of the attesting witnesses in order to pass title to property here when a copy or exemplification thereof duly certified and authenticated by the clerk of the court in which it had been proven and allowed shall be allowed, filed and recorded in the proper county in this State. The doctrine of Hunter v. Kelly, 92 N.C. 285 (1885), is no more the law. Vaught v. Williams, 177 N.C. 77, 97 S.E. 737 (1919).

Due Record and Certificate of Foreign Probate — Effect. — Where a nonresident testator devises land in this State, and the record of foreign court of probate, duly certified, contains the certificate of probate, which refers to the certified examinations of the witnesses, in accordance with the requirements of G.S. 31-17, the whole forming one transaction, the exemplification of which and of the will being duly recorded in the county where the land lies, the will is sufficiently proved and passes the property. Roscoe v. John L. Roper Lumber Co., 124 N.C. 42, 32 S.E. 389 (1899).

A will, duly proven and allowed in New York according to this section, when it appears that an exemplified copy thereof so showing has been recorded here in the county where the land lies, is admissible in evidence in the courts of this State, as a link in a chain of title. Vance v. Guy, 223 N.C. 409, 27 S.E.2d 117 (1943).

Mere Allowance, Filing, and Recordation of Foreign Order of Probate Is Insufficient. — A caveat may not be entered to the recordation of an exemplification or authenticated copy of a will and foreign order of probate that has been allowed, filed, and recorded in the office of the clerk, but can only be entered to the probate of such will. In re Will of Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

Dissent Proceedings. — The will of a South Carolina testator was duly probated there and his widow filed a valid dissent thereto. An authenticated copy of the will to be recorded here, under this section, should include as a muniment of title, the proceedings in dissent as same appear of record in the probate court in the county in which the will was probated. Coble v. Coble, 227 N.C. 547, 42 S.E.2d 898 (1947).

Subscription by Two Witnesses Must Appear from Certificate. — Where a certified copy from another state has been recorded, the fact of subscribing by at least two witnesses must appear affirmatively "in the certificate probate or exemplification of the will." The mere recitation in the attestation clause is not affirmative evidence. Raleigh & W. Ry. v. Glendon & Gulf Mining & Mfg. Co., 113 N.C. 241, 18 S.E. 208 (1893).

Applied in Whitten v. Peace, 188 N.C. 298, 124 S.E. 571 (1924); In re Will of Chatman, 228 N.C. 246, 45 S.E.2d 356 (1947); In re Brauff's Will, 247 N.C. 92, 100 S.E.2d 254 (1957); Brickhouse v. Brickhouse, 104 N.C. App. 69, 407 S.E.2d 607 (1991).

Cited in In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980).

§ 31-28. Probates validated where proof taken by commissioner or another clerk.

In all cases of the probate of any will made prior to March 8, 1899, in common form before any clerk of the superior courts of this State, where the testimony of the subscribing witnesses has been taken in the State or out of it by any commissioner appointed by said clerk or taken by any other clerk of the superior court in any other county of this State, and the will admitted to probate upon such testimony, the proceedings are validated. (1899, c. 680; Rev., s. 3134; C.S., s. 4153.)

§ 31-29. Probates in another state before 1860 validated.

In all cases where any will devises land in this State, and the original will was duly admitted to probate in some other state prior to the year 1860, and a certified copy of such will and the probate thereof has been admitted to probate and record in any county in this State, and it in any way appears from such recorded copy that there were two subscribing witnesses to such will, and its execution was proved by the examination of such witnesses when the original was admitted to probate, such will shall be held and considered, and is hereby declared to be, good and valid for the purpose of passing title to the lands devised thereby, situated in this State, as fully and completely as if the original will had been duly executed and admitted to probate and recorded in this State in accordance with the laws of this State. (1913, c. 93, s. 1; C.S., s. 4155.)

§ 31-30. Validation of wills recorded without probate by subscribing witnesses.

In all cases where wills and testaments were executed prior to the first day of January, 1875, and which appear as recorded in the record of last wills and testaments to have had two or more witnesses thereto, and such last wills and testaments were admitted to probate and recorded in the record of wills in the proper county in this State prior to the first day of January, 1888, without having been duly proven as provided by law, and such wills were presented to the clerk of the superior court in any county in this State where the makers of said wills owned property, and where the makers of such wills lived and died, and were by such clerks recorded in the record of wills for his county, said wills and testaments or exemplified copies or certified true copies thereof, so recorded, if otherwise sufficient, shall have the effect to pass the title to real or personal property, or both, therein devised and bequeathed, to the same extent and as completely as if the execution thereof had been duly proven by the two subscribing witnesses thereto in the manner provided by law of this State. Nothing herein shall be construed to prevent such wills from being impeached for fraud. (1921, c. 66; C.S., s. 4157(a); 1997-81, s. 3.)

§ 31-31. Validation of wills admitted on oath of one subscribing witness.

In all cases where last wills and testaments which appear as recorded in the record of last wills and testaments to have had two witnesses thereto and such last wills and testaments were admitted to probate and recorded in the record of wills in the proper county in this State prior to the first day of January, 1890, upon the oath and examination of one of the witnesses, such proof being taken in writing and recorded, and the certificate of probate of the clerk of the court states that such a will is proven by one of the subscribing witnesses thereto and the handwriting of the other subscribing witness being a nonresident is proven under oath, and such a will and certificate has been recorded in the record of wills of the proper county, such probate is hereby validated as fully as if the proof of the handwriting of the nonresident witness had been taken in regular form in writing and recorded. (1929, c. 41, ss. 1, 2.)

CASE NOTES

Presumption That Proper Will Was Revoked. — Trial court erred by permitting the beneficiaries of the decedent's first will to proceed in a caveat proceeding against the decedent's second will after a prima facie showing of the validity of the second will without first rebutting the presumption that they lacked standing to caveat attendant to their production of a mere copy of the first will, as the presumption then existed that the decedent had revoked the first will. In re Will of Barnes, 157 N.C. App. 144, 579 S.E.2d 585, 2003 N.C. App. LEXIS 643 (2003), cert. denied, 357 N.C. 460, 586 S.E.2d 96 (2003), appeal dismissed, 357 N.C. 460, 586 S.E.2d 95 (2003), cert. denied, petition denied, 357 N.C. 460, 587 S.E.2d 94 (2003).

§ 31-31.1. Validation of probates of wills when witnesses examined before notary public; acts of deputy clerks validated.

Whenever any last will and testament has been probated, based upon the examination of the subscribing witness or the subscribing witnesses, taken before a notary public in the county in which the will is probated, or taken before a notary public of any other county, it is hereby in all respects validated and shall be sufficient to pass the title to all real and personal property purported to be transferred thereby.

All acts heretofore performed by deputy clerks of the superior court in taking acknowledgments, examining witnesses and probate of any wills, deeds and other instruments required or permitted by law to be recorded, are hereby validated. Nothing herein contained shall affect pending litigation. (1945, c. 822; 1973, c. 445; 1977, c. 734, s. 1; 1979, c. 226, s. 2.)

Editor's Note. — Session Laws 1979, c. 226, which reenacted this section without change, provided, in s. 3, that nothing in the act would affect pending litigation and provided, in s. 4, that: "Section 2 of this act shall apply only to those acts performed on or before the effective date of this act." The act was ratified March 29, 1979, and made effective on ratification.

CASE NOTES

Cited in In re Will of Wood, 240 N.C. 134, 81 S.E.2d 127 (1954).

§ 31-31.2. Validation of wills when recorded without order of probate or registration upon oath and examination of subscribing witness or witnesses.

Whenever any last will and testament has been duly presented to the clerk of the superior court, and the said will together with the oath and examination of the subscribing witness or witnesses thereto taken before a notary public in the county in which the will is probated, or taken before a notary public of any other county, or before the clerk of the superior court of said county, or any other county, is duly recorded in the office of the clerk of the superior court of the said county, without a formal order of probate or registration, such will, if executed in accordance with the laws of this State, is hereby validated with respect to the probate and registration thereof and shall be sufficient to pass title to all real and personal property purported to be transferred thereby to the same extent that the said will would have done so if there had been a formal order of probate and registration. This section shall apply only to wills presented to the clerk of the superior court and recorded prior to the first day of January, 1943. (1951, c. 725.)

Article 6.

Caveat to Will.

§ 31-32. When and by whom caveat filed.

At the time of application for probate of any will, and the probate thereof in common form, or at any time within three years thereafter, any person entitled under such will, or interested in the estate, may appear in person or by attorney before the clerk of the superior court and enter a caveat to the probate of such will: Provided, that if any person entitled to file a caveat be within the age of 18 years, or insane, or imprisoned, then such person may file a caveat within three years after the removal of such disability.

Notwithstanding the provisions of the first paragraph of this section, as to persons not under disability, a caveat to the probate of a will probated in common form prior to May 1, 1951, must be filed within seven years of the date of probate or within three years from May 1, 1951, whichever period of time is shorter. (C.C.P., s. 446; Code, s. 2158; Rev., s. 3135; 1907, c. 862; C.S., s. 4158; 1925, c. 81; 1951, c. 496, ss. 1, 2; 1971, c. 1231, s. 1.)

Legal Periodicals. — For brief comment on the 1951 amendment, see 29 N.C.L. Rev. 427 (1951).

For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

CASE NOTES

I. General Consideration.
II. Interested Persons.
III. Time Limit.

I. GENERAL CONSIDERATION.

The purpose of a caveat is to determine whether the paper-writing purporting to be a will is in fact the last will and testament of the person for whom it is propounded. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Filing of a caveat is the customary and statutory procedure for an attack upon the testamentary value of a paper-writing which has been admitted by the clerk of superior court to probate in common form. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

Questions as to the construction of a will may be brought in a declaratory judgment action; however, there are limitations to the use of a declaratory judgment action. Thus, a caveat proceeding and not declaratory judgment was appropriate to determine the validity of document. Rogel v. Johnson, 114 N.C. App. 239, 441 S.E.2d 558, cert. denied, 336 N.C. 609, 447 S.E.2d 401 (1994).

Statute Gives Right and Outlines Procedure. — In this jurisdiction the right to contest a will by caveat is given by statute; and the procedure to be followed is outlined in the statute conferring the right. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

Section Strictly Construed. — This section permitting caveats is in derogation of the common law and must be strictly construed. In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1950).

Superior Court Acquires No Jurisdiction When Purported Caveat Is Fatally Defective from Inception. — Although it is often stated that, when a caveat is filed superior court acquires jurisdiction of whole matter in controversy, such a pronouncement does not alter affirmative statutory requirement that caveat proceedings can only be instituted by due filing of cause before clerk of superior court. When purported caveat is fatally defective from its inception, superior court acquires no jurisdiction over cause. Casstevens v. Wagoner, 99 N.C. App. 337, 392 S.E.2d 776 (1990).

Issue Is Devisavit Vel Non. — Often the issue devisavit vel non is subdivided, according to the angle or nature of the attack, into ancillary issues, the most common of which are those relating to undue influence and testamentary capacity; but every caveat to a will leads to the simple inquiry devisavit vel non, and the rules of procedure are framed with reference to that feature. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

The Contest Is a Special Proceeding In Rem. — The contest of a will by caveat is not an ordinary civil action, but a special proceeding in rem leading to the establishment of the will as a testamentary act under the issue devisavit vel non. The in rem nature of the proceeding dominates the investigation, and in many important respects the parties litigant have little of the usual control over the course of trial on the issue. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948). See In re Will of Westfeldt, 188 N.C. 702, 125 S.E. 531 (1924).

A caveat is an in rem proceeding, perhaps more strictly so regarded than any other proceeding with which the courts deal. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Upon the filing of the caveat, the proceeding is transferred to the civil issue docket for trial before a jury. Upon this transfer, notice is given to all interested persons of the challenge, giving them an opportunity to enter and participate in the proceedings to the end that the court may determine whether the decedent left a will and, if so, whether any of the scripts before the court is the will. The proceeding is in rem, in which the court pronounces its judgment as to whether the res, i.e., the script itself, is the will of the deceased. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965).

The rules peculiar to a caveat stem from the in rem nature of the proceeding. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

A proceeding to contest a will is begun by filing a caveat or objection to probate with the clerk of the superior court, who thereupon transfers the proceeding to the civil issue docket of the superior court to the end that the issue of devisavit vel non may be tried in term by a jury. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950), commented on in 29 N.C.L. Rev. 331 (1951).

Contest of Probate Begun by Caveat. — The proceedings in the matter of the probate of a will is summary and in rem, and the contest of the probate is begun by a caveat under this section. In re Haygood's Will, 101 N.C. 574, 8 S.E. 222 (1888).

When Proceeding in Nature of Caveat Necessary. — Where there is no allegation that the probate of the will was otherwise than in strict accord with the statute, and there is no suggestion that the court was imposed upon or misled, the validity of the will may be attacked only by direct proceeding in the nature of a caveat under this section. In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948), citing In re Little's Will, 187 N.C. 177, 121 S.E. 453 (1924).

It is only by a caveat or proceeding in that nature that the validity of a properly probated will, and one without inherent or fatal defect appearing on its face, may be brought in question. In re Will of Spinks, 7 N.C. App. 417, 173 S.E.2d 1 (1970).

The attack upon a will offered for probate must be direct and by caveat. A collateral attack is not permitted. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965); Johnson v. Stevenson, 269 N.C. 200, 152 S.E.2d 214 (1967).

When a paper-writing purporting to be a will is presented to the judge of probate, he takes proof with respect to its execution. If found in order the script is admitted to probate in common form as a will. Thus far the proceeding is ex parte. It stands as the testator's will, and his only will, until challenged and reversed in a proper proceeding before a competent tribunal. The challenge must be by caveat and be heard in the superior court. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965).

Direct Attack by Caveat Held Adequate Remedy. — Where the grounds on which plaintiff sought to establish a constructive trust in property disposed of by her parents' will were equally available as grounds for direct attack on the will by caveat, this right of direct attack by caveat gave plaintiff a full and complete remedy at law, and she was not entitled to equitable relief. Johnson v. Stevenson, 269 N.C. 200, 152 S.E.2d 214 (1967).

Offering Another Will in Another Proceeding Is Collateral Attack. — Offering another will for probate in another proceeding is a collateral and not a direct attack. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965).

But Any Material Script May Be Presented in Caveat Proceeding. — In a caveat proceeding any interested person may present to the court any script which is material to the issue whether there is a will, and if so, what it is. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965).

Thus, Another Purported Will Should Be Offered in Caveat Proceeding. — Any other script purporting to be the decedent's will should be offered and its validity determined in the caveat proceeding. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965); In re Will of Burton, 267 N.C. 729, 148 S.E.2d 862 (1966).

Clerk of Superior Court Has Exclusive and Original Jurisdiction. — Upon the clerk of the superior court the statutes of this State confer exclusive and original jurisdiction of proceedings for probate of wills. By this it is meant that the clerk of the superior court has the sole power in the first instance to determine whether a decedent died testate or intestate, and if he died testate, whether the script in dispute is his will. Walters v. Baptist Children's Home of N.C., Inc., 251 N.C. 369, 111 S.E.2d 707 (1959).

But when a caveat is filed the superior court acquires jurisdiction of the whole matter in controversy. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965); In re Will of Burton, 267 N.C. 729, 148 S.E.2d 862 (1966).

Scope of Subject Matter Jurisdiction. — Caveat filed by decedent's heirs challenging the validity of the will and codicil whereby decedent left her assets to a university barred a later complaint filed by the heirs to the extent the later filed complaint addressed the same issues as alleged in the caveat. Baars v. Campbell Univ., Inc., 148 N.C. App. 408, 558 S.E.2d 871, 2002 N.C. App. LEXIS 30 (2002), cert. denied, 355 N.C. 490, 563 S.E.2d 563 (2002).

Probate in Common Form Is Valid until Set Aside. — The probate of a will in common form is valid until set aside. In re Beauchamp's Will, 146 N.C. 254, 59 S.E. 687 (1907).

When a will is probated in solemn form it cannot be caveated a second time unless or until the verdict and judgment probating the will in solemn form is set aside upon a motion in the original cause; therefore, the will, if it was first probated in common form, still stands as the last will and testament until declared void in a direct proceeding in the nature of a caveat. In re Will of Burton, 267 N.C. 729, 148 S.E.2d 862 (1966).

And Good Faith Claimants Are Protected until Probate Attacked. — All persons who claim in good faith under a will which has been duly probated in common form as provided by statute are protected by its provisions, until the probate is attacked by a caveat proceeding instituted as provided by this section. Whitehurst v. Hinton, 209 N.C. 392, 184 S.E. 66 (1936).

Nonsuit Cannot Be Taken. — Once the will is propounded for probate in solemn form the proceeding must go on until the issue devisavit vel non is appropriately answered; and no nonsuit can be taken by the propounders or by the caveators. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948). See In re Will of Westfeldt, 188 N.C. 702, 125 S.E. 531 (1924); In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

Because the caveat proceeding is in rem, the proceeding must go on until the issue devisavit vel non is appropriately answered; nonsuit cannot be taken by the propounders or the caveators. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Propounder Functions as Plaintiff. — It is the propounder, and not the caveator, who functions as a plaintiff in a caveat proceeding. In re Will of Parker, 76 N.C. App. 594, 334 S.E.2d 97, cert. denied, 315 N.C. 185, 337 S.E.2d 859 (1985).

An attack upon the validity of a will must be direct and in the form of a caveat. In re Will of Hester, 320 N.C. 738, 360 S.E.2d 801, cert. denied, 321 N.C. 300, 362 S.E.2d 780 (1987).

The trial court may not exclude from the caveat proceeding consideration of any script offered by an interested party which is relevant to the issue devisavit vel non. However, it does not mandate that the issues relating to all scripts be considered simultaneously. In re Will of Hester, 320 N.C. 738, 360 S.E.2d 801, cert. denied, 321 N.C. 300, 362 S.E.2d 780 (1987).

Burden of Proof. — Although a caveat proceeding is an in rem proceeding without a plaintiff and a defendant as such, it is the propounder who has the initial burden of proof, namely, to prove that the instrument in question was executed with the proper formalities required by law. Once this has been established, the burden shifts to the caveator to show that the execution of the will was procured by undue influence. In re Will of Parker, 76 N.C. App. 594, 334 S.E.2d 97, cert. denied, 315 N.C. 185, 337 S.E.2d 859 (1985).

Although a trial court properly granted summary judgment to an executor where there was no evidence of a lack of testamentary capacity, the trial court erred in finding estoppel and no undue influence; a caveator showed that the caveator would have received a bequest in any event and that there were genuine issues of material fact relating to undue influence. In re Will of Smith, 158 N.C. App. 722, 582 S.E.2d 356, 2003 N.C. App. LEXIS 1229 (2003).

Burden of Proof Satisfied. — In a caveat proceeding the propounders satisfied their burden of showing that there was no genuine issue of fact in controversy and that they were entitled to judgment as a matter of law when they submitted caveator's release and renunciation in support of their motion for summary judgment. In re Will of Edgerton, 29 N.C. App. 60, 223 S.E.2d 524, cert. denied, 290 N.C. 308, 225 S.E.2d 832 (1976).

Filing of Caveat as Ground for Modification of Will. — Mere fact that a caveat has been filed, standing alone, is not sufficient ground for modification of the dispositive provisions of a will; the outcome of the litigation must be in doubt to such extent that it is advisable for persons affected to accept the proposed modifications rather than run the risk of the more serious consequences that would result from an adverse verdict. Holt v. Holt, 304 N.C. 137, 282 S.E.2d 784 (1981).

Heirs Not Cited under § 31-33. — The heirs at law of a deceased testator whose will is duly probated and who have no knowledge of proceedings to caveat the will, and who were not cited under the provisions of G.S. 31-33, are not estopped to file a second caveat to the paper-writing, nor bound by the former judgment therein sustaining the validity of the paper-writing propounded. Mills v. Mills, 195 N.C. 595, 143 S.E. 130 (1928).

Where plaintiffs attempted to initiate purported caveat proceedings directly in superior court as part of attack on validity of a deed, trial court had no subject matter jurisdiction to determine will's validity. Casstevens v. Wagoner, 99 N.C. App. 337, 392 S.E.2d 776 (1990).

Mere Allowance, Filing, and Recordation of Foreign Order of Probate Is Insufficient. — A caveat may not be entered to the recordation of an exemplification or authenticated copy of a will and foreign order of probate that has been allowed, filed, and recorded in the office of the clerk, but can only be entered to the probate of such will. In re Will of Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

Applied in In re Will of Roediger, 209 N.C. 470, 184 S.E. 74 (1936); In re Will of Peacock, 18 N.C. App. 554, 197 S.E.2d 254 (1973); In re Will of Joyner, 35 N.C. App. 666, 242 S.E.2d 213 (1978); Lash ex rel. Wilson v. Lash, 107 N.C. App. 755, 421 S.E.2d 615 (1992).

Cited in In re Bartlett's Will, 235 N.C. 489, 70 S.E.2d 482 (1952); In re Will of Edgerton, 26 N.C. App. 471, 216 S.E.2d 476 (1975).

II. INTERESTED PERSONS.

This section affords protection to any interested persons who do not receive notice. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

This section permits a person in interest to file a caveat to an alleged will offered for probate, and to contest the validity of such alleged will before it has been admitted to probate. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950), commented on in 29 N.C.L. Rev. 331; Walters v. Baptist Children's Home of N.C., Inc., 251 N.C. 369, 111 S.E.2d 707 (1959); In re Will of Lamb, 303 N.C. 452, 279 S.E.2d 781 (1981).

Any interested person may challenge the will and contest its validity by filing a caveat setting forth the grounds of the challenge. In re Will of Charles, 263 N.C. 411, 139 S.E.2d 588 (1965).

Where a will is probated in common form any interested party may appear and enter a caveat. In re Hedgepeth's Will, 150 N.C. 245, 63 S.E. 1025 (1909); In re Thompson's Will, 178 N.C. 540, 101 S.E. 107 (1919); Whitehurst v. Abbott, 225 N.C. 1, 33 S.E.2d 129 (1945).

Any person who has such a direct, immediate, and legally ascertained pecuniary interest in the devolution of the testator's estate as would be impaired or defeated by the probate of the will, or be benefited by setting aside the will, is "a person interested." In re Thompson's Will, 178 N.C. 540, 101 S.E. 107 (1919).

The general rule is that a contestant under this section must have some pecuniary or beneficial interest in the estate that is detrimentally affected by the will. In re Will of Calhoun, 47 N.C. App. 472, 267 S.E.2d 385, cert. denied, 301 N.C. 90, 273 S.E.2d 311 (1980).

Caveators Presented Evidence of Detrimental Affect of Probate. — As caveators presented evidence that they were devisees in a testator's later will, but were not included in his earlier will, they presented sufficient evidence that they would be affected detrimentally by the probate of the earlier will and thus had standing to file a caveat regarding that will under G.S. 31-32. In re Will of McFayden, 179 N.C. App. 595, 635 S.E.2d 65, 2006 N.C. App. LEXIS 2053 (2006).

A caveat to a will may be filed only by persons "entitled under such will or interested in the estate." And G.S. 31-33, directing the issue of citations, "to all devisee, legatees, or other parties in interest," does not enlarge the definition of interest given in this section. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

The right to interfere in a question of probate belongs to a party in interest, which must mean some person whose rights will be affected by the probate of the instrument to the prejudice of the party. In re Thompson's Will, 178 N.C. 540, 101 S.E. 107 (1919). See Armstrong v. Baker, 31 N.C. 109 (1848).

The right to contest the validity of a writing offered for probate or probated in common form is, by this section, limited to "any person entitled under such will or interested in the estate." In re Will of Belvin, 261 N.C. 275, 134 S.E.2d 225 (1964).

Person Interested Against Will May Both Apply for Probate and File Caveat. — The probate powers of the judiciary afford a complete remedy to a person interested against an alleged will in instances where those interested for the alleged will do not propound it for probate. He may invoke such remedy by the simple expedient of simultaneously applying to the clerk of the superior court having jurisdiction to have the script probated or proved, i.e., tested, and filing a caveat asking that it be declared invalid as a testamentary instrument. Brissie v. Craig, 232 N.C. 701, 62 S.E.2d 330 (1950), commented on in 29 N.C.L. Rev. 331.

It is immaterial whether those appearing and protesting call themselves interveners, objectors or caveators if they place themselves in opposition to the propounders. By a caveat legal rights are put in stake. In re Will of Rowland, 202 N.C. 373, 162 S.E. 897 (1932); In re Will of Puett, 229 N.C. 8, 47 S.E.2d 488 (1948).

It takes only one interested person to caveat a will under this section, and it becomes the duty of the clerk thereupon to bring in interested persons under G.S. 31-33. When they come in they may align themselves as they will. Bailey v. McLain, 215 N.C. 150, 1 S.E.2d 372 (1939), discussed in 18 N.C.L. Rev. 76.

Purchasers from Heirs May File Caveat. — The purchasers of land from the heirs of the deceased owner "are interested in the estate" within the intent and meaning of this section. In re Thompson's Will, 178 N.C. 540, 101 S.E. 107 (1919).

Beneficiaries under Alleged Prior Will Are Interested. — Caveators who allege they are beneficiaries under a prior will of deceased made at a time when he possessed mental capacity are, if the facts be as alleged, interested in the estate. In re Will of Belvin, 261 N.C. 275, 134 S.E.2d 225 (1964).

Beneficiaries under a prior paper-writing are persons interested within the purview of this section and are entitled to file a caveat to a subsequent instrument probated in common form, notwithstanding they are not heirs of the deceased and are not named as beneficiaries in the writing they seek to nullify. Sigmund Sternberger Found. v. Tannenbaum, 273 N.C. 658, 161 S.E.2d 116 (1968).

Beneficiaries Under Alleged Prior Will Failed to Overcome Presumption of the Revocation of the Prior Will. — Trial court erred by permitting the beneficiaries of the decedent's first will to proceed in a caveat proceeding against the decedent's second will without first rebutting the presumption that they lacked standing to caveat attendant to their production of a mere copy of the first will, as the presumption then existed that the decedent had revoked the first will. In re Will of Barnes, 157 N.C. App. 144, 579 S.E.2d 585, 2003 N.C. App. LEXIS 643 (2003), cert. denied, 357 N.C. 460, 586 S.E.2d 96 (2003), appeal dismissed, 357 N.C. 460, 586 S.E.2d 95 (2003), cert. denied, petition denied, 357 N.C. 460, 587 S.E.2d 94 (2003).

Executor. — A named executor is not a person interested in the event of the caveat proceeding within the meaning of the dead man's statute. In re Will of Hester, 84 N.C. App.

585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Membership in Congregation. — Membership in a church congregation, albeit distinguished membership, is too tenuous an interest to come within the meaning of the dead man's statute. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Inadequacy of Relief Through Caveat Proceeding Entitled Decedent's Step-grandchildren to Proceed on Tort Claim. — Superior court erroneously dismissed a claim filed by two of decedent's step-grandchildren that defendants, two of the decedent's other step-grandchildren, maliciously caused their step-grandmother to execute a will that left them only nominal bequests, as: (1) the movant step-grandchildren would not be able to obtain adequate relief through a caveat proceeding; and (2) it did not appear that the step-grandchildren could not prove a set of facts supporting their claim which would entitle them to relief. Murrow v. Henson, 172 N.C. App. 792, 616 S.E.2d 664, 2005 N.C. App. LEXIS 1809 (2005).

III. TIME LIMIT.

Purpose. — By this section, the legislature recognized that it is against the sound public policy to allow probate of wills and settlements of property rights thereunder to be left open to uncertainties for an indefinite length of time. In re Will of Johnson, 182 N.C. 522, 109 S.E. 373 (1921).

Time Limitation Is Substantive. — The time limitation contained in this section has been held to be a "substantive" limitation on the right of action. In re Evans, 46 N.C. App. 72, 264 S.E.2d 387 (1980).

When Probate May Be Caveated. — The probate of a will in common form, being an ex parte proceeding on application of the propounder, may be caveated at the time of application for probate or at any time within seven (now three) years thereafter by "any person entitled under such will, or interested in the estate." In re Ellis' Will, 235 N.C. 27, 69 S.E.2d 25 (1952).

Prior to the 1907 amendment there was no express period of limitation upon the right to file a caveat to the probate of a will, but it was judicially recognized that the right might be lost by unreasonable delay. Gray v. Maer, 20 N.C. 41 (1838); Etheridge v. Corprew, 48 N.C. 14 (1855); In re Beauchamp's Will, 146 N.C. 254, 59 S.E. 687 (1907); In re Hedgepeth's Will, 150 N.C. 245, 63 S.E. 1025 (1909); In re Dupree, 163 N.C. 256, 79 S.E. 611 (1913); In re Bateman's Will, 168 N.C. 234, 84 S.E. 272 (1915); In re Witherington's Will, 186 N.C. 152, 119 S.E. 11 (1923).

Only Extrinsic Fraud Tolls Period of Limitation. — The general rule is that when a statute creating the right to contest a will and imposing a limitation of time therefor is construed as affixing an inseparable condition to the exercise of the right, that period so limited will not be tolled by fraud other than extrinsic fraud which would vitiate the probate proceeding. In re Evans, 46 N.C. App. 72, 264 S.E.2d 387 (1980).

A contest not timely instituted based on other than extrinsic fraud is wholly barred although by reason of the wrongful conduct of the propounder, the contestants were not apprised of the situation soon enough to comply with the limitation requirement. In re Evans, 46 N.C. App. 72, 264 S.E.2d 387 (1980).

Intrinsic and Extrinsic Fraud Distinguished. — The question of fraud in obtaining the execution of a will, undue influence, forgery, and the like may be submitted to the probate court in a direct attack on the will by caveat. Fraud of this nature is intrinsic fraud. Extrinsic fraud, on the other hand, relates to the manner in which the judgment is procured. It must relate to matters not in issue and prevent a real contest in the trial. In re Evans, 46 N.C. App. 72, 264 S.E.2d 387 (1980).

Question of Whether Cause Barred as Matter of Law. — While ordinarily whether a cause is barred by the apposite statute of limitations is a mixed question of law and fact, where the facts are admitted or established, the question of the bar of the applicable statute pleaded becomes a question of law, and when such facts disclose that the action is barred the court may sustain the plea and dismiss the action. In re Evans, 46 N.C. App. 72, 264 S.E.2d 387 (1980).

Condition Not Subject to Waiver. — The requirement that caveat proceedings be instituted within seven (now three) years from the probate of the will in common form is a condition attached to the right to file caveat and may not be waived by the parties. In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1950).

Attack on Will for Vagueness and Uncertainty. — A will is not subject to caveat or collateral attack 27 years after it has been probated in common form; but if the will is void for vagueness and uncertainty it is a nullity and may be attacked directly or collaterally or treated as ineffective, anywhere at any time. Burchett v. Mason, 233 N.C. 306, 63 S.E.2d 634 (1951).

Caveat in Spite of Outstanding Life Estate. — One who is authorized by law to caveat a will is not required to await the falling-in of an outstanding life estate, and such time is not excluded from the computation of period limited in which a caveat to a will may be filed. In re Will of Witherington, 186 N.C. 152, 119 S.E. 11 (1923).

Application to Clerk within Time No Excuse for Delay. — Where parties seeking to caveat a will have forfeited their right to do so by unreasonable delay and acquiescence, the mere fact that they had applied several times when their rights would have been allowed, and the clerk declined and refused to entertain the application because the parties failed to give a proper bond as required by law, does not affect the result, for no caveat is properly constituted until the statutory requirements are met; and if it had been so constituted, the absence of notice issued in reasonable time works a discontinuance. In re Dupree, 163 N.C. 256, 79 S.E. 611 (1913).

Married Women. — Since the enactment of statutes fully emancipating a feme covert from her disabilities, the provisions of this section barring the right to caveat a will after seven years (now three years) with certain exceptions, apply equally to her. In re Will of Witherington, 186 N.C. 152, 119 S.E. 11 (1923).

§ 31-33. Bond given and cause transferred to trial docket.

When a caveator shall have given bond with surety approved by the clerk, in the sum of two hundred dollars ($200.00), payable to the propounder of the will, conditioned upon the payment of all costs which shall be adjudged against such caveator in the superior court or when a caveator shall have deposited money or given a mortgage in lieu of such bond, or shall have filed affidavits and satisfied the clerk of his inability to give such bond or otherwise secure such costs, the clerk shall transfer the cause to the superior court for trial. Such caveator shall cause notice of the caveat proceeding to be given to all devisees, legatees, or other persons in interest in the manner provided for service of process by G.S. 1A-1, Rule 4(j) and (k). The notice shall advise such devisees, legatees, or other persons in interest, of the session of superior court to which the proceeding has been transferred and shall call upon them to appear and make themselves proper parties to the proceeding if they so choose. At the session of court to which such proceeding is transferred, or as soon thereafter as motion to that effect shall be made by the propounder, and before trial, the judge shall require any of the devisees, legatees or other persons in interest so cited, either those who make themselves parties with the caveators or whose interests appear to him antagonistic to that of the propounders of the will, to align themselves and to file bond within such time as he shall direct and before trial. Upon the failure of any party to file such bond, the judge shall dismiss that party from the proceeding but that party shall be bound by the proceeding. (C.C.P., s. 447; Code, s. 2159; 1899, c. 13; 1901, c. 748; Rev., s. 3136; 1909, c. 74; C.S., s. 4159; 1947, c. 781; 1971, c. 528, s. 29; 1973, c. 458.)

Cross References. — For provisions requiring clerk to transfer issues of fact to civil issue docket, see G.S. 1-273 [see now G.S. 1-301.1 et seq.].

Legal Periodicals. — For brief comment on the 1947 amendment, see 25 N.C.L. Rev. 478 (1947).

CASE NOTES

Court Had No Jurisdiction to Determine Will's Validity Where Plaintiff's Attempt to Initiate Caveat Was Part of Attack on Deed. — Where plaintiffs attempted to initiate purported caveat proceedings directly in superior court as part of attack on validity of a deed, trial court had no subject matter jurisdiction to determine question of will's validity. Casstevens v. Wagoner, 99 N.C. App. 337, 392 S.E.2d 776 (1990).

Although it is often stated that, when a caveat is filed superior court acquires jurisdiction of whole matter in controversy, such a pronouncement does not alter affirmative statutory requirement that caveat proceedings can only be instituted by due filing of cause before clerk of superior court. When a purported caveat is fatally defective from its inception, superior court acquires no jurisdiction over cause. Casstevens v. Wagoner, 99 N.C. App. 337, 392 S.E.2d 776 (1990).

Clerk's Findings Not Binding When Issue of Fact Raised. — Interested parties in a proceeding before a clerk of the Superior Court to probate a will in solemn form are not bound by the findings of the clerk where an issue of fact is raised by the parties. In re Will of Ellis, 235 N.C. 27, 69 S.E.2d 25 (1952).

Proceedings Transferred to Civil Issue Docket. — Where a caveat to a will is duly filed, with the required bond, etc., it is required of the clerk to transfer the proceedings to the civil issue docket for trial of the issue of devisavit vel non, and all further steps are stayed in the matter until its final adjudication, except such as may be necessary for the preservation of the estate. In re Little's Will, 187 N.C. 177, 121 S.E. 453 (1924).

When a caveat is filed, the clerk of superior court transfers the proceeding to the civil issue docket of the superior court, to the end that the issue devisavit vel non may be tried by a jury. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

For Trial by Jury. — When an issue of devisavit vel non is raised by caveat it is tried in the superior court by a jury. In re Will of Chisman, 175 N.C. 420, 95 S.E. 769 (1918); In re Rowland, 202 N.C. 373, 162 S.E. 897 (1932); In re Bartlett's Will, 235 N.C. 489, 70 S.E.2d 482 (1952).

When a caveat is filed and bond given, the clerk does not take testimony, he submits no issue to the jury, but immediately transfers the cause to the superior court in term, which submits to a jury issues necessary to determine the validity of the instrument asserted to be the will of deceased. In re Will of Belvin, 261 N.C. 275, 134 S.E.2d 225 (1964).

Which Cannot Be Waived. — Upon the proper filing of a caveat the cause must be transferred to the civil issue docket where the proceeding is in rem for trial by jury, and neither party may waive jury trial, consent that the court hear the evidence and find the determinative facts or have nonsuit entered at his instance. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947). See In re Will of Roediger, 209 N.C. 470, 184 S.E. 74 (1936).

Upon such trial the propounder carries the burden of proof to establish the formal execution of the will. This he must do by proving the will per testes in solemn form. In re Will of Chisman, 175 N.C. 420, 95 S.E. 769 (1918); In re Rowland, 202 N.C. 373, 162 S.E. 897 (1932).

Upon the filing of a caveat to a will probated in common form the propounder must prove the will per testes in solemn form, and the burden is upon him to show (1) the formal execution as prescribed by statute; (2) the contents, if the original was not produced; (3) the loss of the original will or that it had not been destroyed by the testator or with his consent or procurement. In re Hedgepeth's Will, 150 N.C. 245, 63 S.E. 1025 (1909).

Compliance with this section in respect to bond for costs is prerequisite to the institution of a caveat proceeding, and the mere filing of the caveat without compliance with the statute constitutes no valid attack upon the will and is insufficient to authorize the clerk to issue the required citations to bring interested parties into court. In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1950).

Where caveat is filed without compliance with this section relating to bond, there is no valid caveat, and after the expiration of seven (now three) years the right to file caveat ceases to exist and may not be revived by the giving of a cash bond under an extension of time granted by the court after the expiration of the statutory period. In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1950).

Caveat filed without compliance with bond requirement under this section is not a valid attack upon the will. In re Will of Parker, 76 N.C. App. 594, 334 S.E.2d 97, cert. denied, 315 N.C. 185, 337 S.E.2d 859 (1985).

Heirs-at-Law Should Have Been Dismissed for Failing to File a Bond After Notice of Caveat Proceeding Was Received. — Trial judge should have dismissed the heirs-at-law from a caveat proceeding for not filing a bond after they received notice of the proceeding. In re Will of Barnes, 157 N.C. App. 144, 579 S.E.2d 585, 2003 N.C. App. LEXIS 643 (2003), cert. denied, 357 N.C. 460, 586 S.E.2d 96 (2003), appeal dismissed, 357 N.C. 460, 586 S.E.2d 95 (2003), cert. denied, petition denied, 357 N.C. 460, 587 S.E.2d 94 (2003).

A check deposited with the clerk to be held in lieu of bond is insufficient to meet the requirements of this section. In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1950).

Bringing in Interested Persons. — In this State it takes only one interested person to caveat a will under G.S. 31-32 and it becomes the duty of the clerk, under this section, to bring in interested persons. When they come in they may align themselves as they will. Bailey v. McLain, 215 N.C. 150, 1 S.E.2d 372 (1939).

The persons interested are not cited as parties to the proceeding but merely as interested persons to view proceedings and participate if they elect to do so, although no doubt the court, when properly and timely advised, would cause citation to issue to anyone designated by statute as interested who has been omitted. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

In a caveat proceeding, neither the grantees in deeds executed by testator prior to his death nor the persons to whom such grantees have conveyed the property, either before or after testator's death, nor the heirs at law of deceased grantees are necessary parties to the determination of the issue of devisavit vel non when such persons are not beneficiaries under the will nor heirs of testator, and therefore, even if it be conceded they are proper parties, the trial judge, in the exercise of his discretion, is under no legal obligation to order citations to bring them in. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

Who Are Necessary Parties. — Persons who qualify as persons interested in the estate are not necessarily equivalent to necessary parties. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Discretion of Court as to Necessary Parties. — The decision whether certain persons are necessary parties to the caveat proceeding is within the court's discretion. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Persons who will share in the estate under the law governing intestacy in case a script which purports to be the will of the deceased is adjudged invalid are proper persons to receive notice and participate in the proceedings within the meaning of this section. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Beneficiaries Under Previous Will. — Where caveators alleged that probated will was invalid on grounds of undue influence and lack of mental capacity and that they were beneficiaries under a will made at a time when the testator possessed mental capacity, if the facts were as caveators alleged, they were interested in the estate. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

Heirs at law who have no knowledge of a caveat proceeding and who were not cited under this section are not estopped to file a second caveat, nor are they bound by the former judgment sustaining the validity of the script. In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643, rev'd on other grounds, 320 N.C. 738, 360 S.E.2d 801 (1987).

When Personal Representative of Executrix Not Necessary Party. — Where the executrix has fully administered the estate and filed her final account prior to the filing of a caveat, and has died pending the caveat proceeding, it is not necessary that the court appoint a personal representative for the deceased executrix nor an administrator d.b.n. for the estate of the testator so that they may be made parties to the proceeding. In re Will of Brock, 229 N.C. 482, 50 S.E.2d 555 (1948).

Cited in Mills v. Mills, 195 N.C. 595, 143 S.E. 130 (1928); Muncie v. Travelers Ins. Co., 253 N.C. 74, 116 S.E.2d 474 (1960); In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980).

§ 31-34. Prosecution bond required in actions to contest wills.

When any action is instituted to contest a will the clerk of the superior court will require the prosecution bond required in other civil actions: Provided, however, that provisions for bringing suit in forma pauperis shall also apply to the provisions of this section. (1937, c. 383.)

Legal Periodicals. — As to purpose of section, see 15 N.C.L. Rev. 352 (1937).

CASE NOTES

This section is not applicable to a caveator. Therefore, a prosecution bond cannot be required of a caveator in an action to contest a will. In re Will of Parker, 76 N.C. App. 594, 334 S.E.2d 97, cert. denied, 315 N.C. 185, 337 S.E.2d 859 (1985).

§ 31-35. Affidavit of witness as evidence.

Whenever the subscribing witness to any will shall die, or be insane or mentally incompetent, or be absent beyond the State, it shall be competent upon any issue of devisavit vel non to give in evidence the affidavits and proofs taken by the clerk upon admitting the will to probate in common form, and such affidavit and proceedings before the clerk shall be prima facie evidence of the due and legal execution of said will. (1899, c. 680, s. 2; Rev., s. 3121; C.S., s. 4160; 1947, c. 781.)

Legal Periodicals. — For brief comment on the 1947 amendment, see 25 N.C.L. Rev. 478 (1947).

§ 31-36. Caveat suspends proceedings under will.

Where a caveat is entered and bond given, the clerk of the superior court shall forthwith issue an order to any personal representative, having the estate in charge, to suspend all further proceedings in relation to the estate, except the preservation of the property and the collection of debts and payment of all taxes and debts that are a lien upon the property of the decedent, as may be allowed by order of the clerk of the superior court, until a decision of the issue is had. (C.C.P., s. 448; Code, s. 2160; Rev., s. 3137; C.S., s. 4161; 1927, c. 119.)

CASE NOTES

Purpose of Section. — This section is manifestly intended, in cases to which it is applicable, to dispense with the necessity of appointing an administrator pendente lite, and confers very similar forms upon the executor, and more especially when he has entered upon the duties of his office before the caveat is entered. Syme v. Broughton, 86 N.C. 153 (1882).

The prosecution of the action in order to collect the debts is evidently sanctioned by the statute and in furtherance of the purpose of its enactment. Hughes v. Hodges, 94 N.C. 56 (1886).

Effect of Caveat upon Rights and Duties of Representative. — The filing of a caveat suspends further proceedings in the administration of the estate, but does not deprive the executor or executrix of the right to the possession of the assets of the estate. Elledge v. Hawkins, 208 N.C. 757, 182 S.E. 468 (1935).

The executor is not divested of all his representative powers; nor is the first probate vacated absolutely when the issue touching the will is made up to be tried; nor is there a necessity meanwhile for the appointment of an administrator pendente lite. The function of the executor is suspended only until the controversy is ended, and he is still required to take care of the estate in his hands and may proceed in the collection of debts due the deceased. Randolph v. Hughes, 89 N.C. 428 (1883); In re Palmer, 117 N.C. 133, 23 S.E. 104 (1895).

In the observance of the mandate to preserve the property the executor may operate and manage the property in the exercise of that degree of care, diligence and honesty which he would exercise in the management of his own property, or he may institute a civil action in which all persons having an interest are made parties and request the court in its equity jurisdiction to authorize such operation, or he may apply to the clerk in his probate jurisdiction for such authorization. C.L. Hardy & Co. v. Turnage, 204 N.C. 538, 168 S.E. 823 (1933).

Preservation of Estate Pending Final Determination of Issue. — Under the provisions of this section, the executor is charged with the preservation of the estate pending final determination of the issue raised by the caveat, unless and until he be removed, and it is error for the court to appoint commissioners to handle the estate. In re Tatum's Will, 233 N.C. 723, 65 S.E.2d 351 (1951).

Suspension does not prevent the administrator from suing and being sued. Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965).

Thus, administrator has authority to defend an action against the estate for collection of an alleged debt. Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965).

May Be Sued and Sell Land; May Not Pay Legacies. — An executor, or administrator c.t.a., after the will is proved in common form, may be sued, and by leave of court may sell property to pay debts, but cannot pay legacies or exercise other special powers given in the will, where issues upon a caveat are pending; the right to execute the will is suspended until the determination of the suit. Syme v. Broughton, 86 N.C. 153 (1882).

Office of Representative Continued. — The proper construction of this section is that after probate is granted in common form and there is an executor who acts or an administrator with the will annexed appointed, his office is intended to be continued during a controversy about the will, and he has all the power and is subjected to all the liabilities of an administrator or an executor, except that his right to dispose of the estate according to the provisions of the will is suspended until the final determination of the suit. In re Palmer, 117 N.C. 133, 23 S.E. 104 (1895).

Effect of Absence of Order to Suspend Proceeding. — In the absence of an order to suspend further proceedings upon the filing of a caveat, as provided by this section, the acts of the executor in filing a petition or proceeding with the sale of the land were not void nor were the rights of purchasers affected. Carraway v. Lassiter, 139 N.C. 145, 51 S.E. 968 (1905).

The clerk of a superior court cannot enter an order vacating the probate of a will after a caveat has been filed and the cause transferred to the civil issue docket of the superior court for trial in term. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947). See note to § 31-19.

Where the clerk of the superior court has admitted to probate in common form a purported will and two purported codicils as the last will and testament of a deceased, and caveat has been properly filed as to the second codicil and the cause transferred to the civil issue docket, the clerk may not thereafter upon motion expunge from his records the entire probate proceedings and reprobate the purported will and second codicil on the ground that the second codicil revoked the first. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

Error Held Not Cured by Affirmance of Order. — Where a clerk is without jurisdiction to make an order in probate proceedings, by reason of the filing of a caveat and the transfer of the cause to the civil issue docket, the error in making the order is not cured by the order of the resident judge of the superior court who heard the motion on appeal and affirmed the order, for the jurisdiction of the superior court in such a case is derivative, and G.S. 1-276 [see now G.S. 1-301.1 et seq.] does not apply. In re Will of Hine, 228 N.C. 405, 45 S.E.2d 526 (1947).

Cited in In re Will of Covington, 252 N.C. 546, 114 S.E.2d 257 (1960); In re Will of Lamb, 48 N.C. App. 122, 268 S.E.2d 831 (1980); In re Will of Hester, 84 N.C. App. 585, 353 S.E.2d 643 (1987).

§ 31-37. Superior court clerks to enter notice of caveat on will book; final judgment also to be entered.

Wherever a caveat is filed with the clerk of the superior court of any county in the State to any last will and testament which has been admitted to probate in said office, it shall be the duty of such clerk, and he is hereby directed to give notice of the filing of such caveat by making an entry upon the page of the will book where such last will and testament is recorded, evidencing that such caveat has been filed and giving the date of such filing. When such caveat and proceedings resulting therefrom shall have resulted in final judgment with respect to such will, the clerk of the court shall make a further entry upon the page of the will book where such last will and testament is recorded to the effect that final judgment has been entered, either sustaining or setting aside such will. (1929, c. 81.)

CASE NOTES

Applied in Lewis v. Furr, 228 N.C. 89, 44 S.E.2d 604 (1947).

Cited in In re Estate of Peebles, 118 N.C. App. 296, 454 S.E.2d 854 (1995).

§ 31-37.1. Parties may enter into a settlement agreement.

Prior to an entry of judgment by the superior court in a caveat proceeding, the parties may enter into a settlement agreement, whereupon judgment may be entered by the court, without a verdict by a jury, in accordance with the terms of the settlement agreement, either sustaining or setting aside the contested will. (1989 (Reg. Sess., 1990), c. 949, s. 1.)

Article 7.

Construction of Will.

§ 31-38. Devise presumed to be in fee.

When real estate shall be devised to any person, the same shall be held and construed to be a devise in fee simple, unless such devise shall, in plain and express words, show, or it shall be plainly intended by the will, or some part thereof, that the testator intended to convey an estate of less dignity. (1784, c. 204, s. 12; R.C., c. 119, s. 26; Code, s. 2180; Rev., s. 3138; C.S., s. 4162.)

Legal Periodicals. — For article, "Does the Fee Tail Exist in North Carolina?," see 23 Wake Forest L. Rev. 767 (1988).

CASE NOTES

I. General Consideration.
II. Rules of Construction.
III. Illustrative Cases.

I. GENERAL CONSIDERATION.

Section Changes Common-Law Rule. — The common-law rule that a devise without words of perpetuity or limitation conveyed a life estate only unless there is a manifest intention to convey the fee has been changed by this section. Henderson v. Western Carolina Power Co., 200 N.C. 443, 157 S.E. 425 (1931).

This section merely changed the common-law rule that a devise without words of perpetuity or limitation conveyed a life estate only. Thompson v. Ward, 36 N.C. App. 593, 244 S.E.2d 485, cert. denied, 295 N.C. 556, 248 S.E.2d 735 (1978).

The purpose of this section was to change the common-law rule that a devise of lands without words of perpetuity conveyed a life estate only unless there was a manifest intention to convey the fee. Morris v. Morris, 246 N.C. 314, 98 S.E.2d 298 (1957); Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960).

And it is similar to § 39-1 pertaining to deeds. Hence, what has been held in applying the rule of construction as to wills is pertinent in applying the rule of construction as to deeds. Artis v. Artis, 228 N.C. 754, 47 S.E.2d 228 (1948). See Vickers v. Leigh, 104 N.C. 248, 10 S.E. 308 (1889).

Section Applies to Real and Personal Property. — The provisions of this section apply to the disposition by will of both personal and real property. Worsley v. Worsley, 260 N.C. 259, 132 S.E.2d 579 (1963); YWCA v. Morgan, 281 N.C. 485, 189 S.E.2d 169 (1972).

The presumption created by this section by its own terms may be overcome by a showing that the will plainly intended to convey an estate of less dignity. Adcock v. Perry, 305 N.C. 625, 290 S.E.2d 608 (1982).

Where testator, after devising his wife a life estate in his realty with remainder over to his children, bequeathed his wife "all or so much of my personal property ... as she may desire to have and to use or dispose of during her lifetime," and directed that all personal property not so sold or disposed of should be divided among his children, the residuary legatees, it was held that the expressed intent of the testator negatived the statutory presumption that he gave his personal estate unconditionally to his wife. Worsley v. Worsley, 260 N.C. 259, 132 S.E.2d 579 (1963).

The presumption established by this section that a devise of land shall be construed in fee, etc., gives way to the intent of the testator as gathered from the proper construction of the instrument as a related whole. Roberts v. Saunders, 192 N.C. 191, 134 S.E. 451 (1926).

A general devise of realty does not pass the fee when it clearly appears from the will that the testator intended to convey an estate of less dignity. Hampton v. West, 212 N.C. 315, 193 S.E. 290 (1937); Strickland v. Johnson, 213 N.C. 581, 197 S.E. 193 (1938).

The rule that a devise of the "use of" property is the equivalent of a devise in fee ... has no application when a will shows an intent to pass an interest that is less than a fee. Cassada v. Cassada, 103 N.C. App. 129, 404 S.E.2d 491, cert. denied, 329 N.C. 786, 408 S.E.2d 516 (1991).

Unrestricted Devise Passes Fee. — It has been uniformly held, since the passage of this statute in 1784, that an unrestricted devise of real estate passes the fee. Roane v. Robinson, 189 N.C. 628, 127 S.E. 626 (1925); Barbee v. Thompson, 194 N.C. 411, 139 S.E. 838 (1927); Bell v. Gillam, 200 N.C. 411, 157 S.E. 60 (1931); Stephens v. Clark, 211 N.C. 84, 189 S.E. 191 (1937); Strickland v. Johnson, 213 N.C. 581, 197 S.E. 193 (1938).

An unrestricted devise of realty, nothing else appearing, constitutes a devise in fee. Elder v. Johnston, 227 N.C. 592, 42 S.E.2d 904 (1947).

An unrestricted or indefinite devise of real property is regarded as a devise in fee simple. Adcock v. Perry, 52 N.C. App. 724, 279 S.E.2d 871 (1981), rev'd on other grounds, 305 N.C. 625, 290 S.E.2d 608 (1982).

A devise generally or indefinitely with power of disposition creates a fee. But a devise for life with power of disposition creates a life estate only. Hardee v. Rivers, 228 N.C. 66, 44 S.E.2d 476 (1947).

Unless a will contains plain and express language, showing that the testator did not intend to devise a fee, the devise will be construed as one in fee simple. Basnight v. Dill, 256 N.C. 474, 124 S.E.2d 159 (1962); Adcock v. Perry, 52 N.C. App. 724, 279 S.E.2d 871 (1981), rev'd on other grounds, 305 N.C. 625, 290 S.E.2d 608 (1982).

No technical words of conveyance are required in wills. Alston v. Davis, 118 N.C. 202, 24 S.E. 15 (1896); Keith v. Scales, 124 N.C. 497, 32 S.E. 809 (1899).

Words of Perpetuity Not Required to Create Fee. — Since this section no words of perpetuity are required and a devise without them will carry the fee unless it appears from the will the testator intended to convey an estate less than the fee. Morris v. Morris, 246 N.C. 314, 98 S.E.2d 298 (1957).

Applied in Morris v. Waggoner, 209 N.C. 183, 183 S.E. 353 (1936); Blackwood v. Blackwood, 237 N.C. 726, 76 S.E.2d 122 (1953); Walters v. Baptist Children's Home of N.C., Inc., 251 N.C. 369, 111 S.E.2d 707 (1959); Poindexter v. Wachovia Bank & Trust Co., 258 N.C. 371, 128 S.E.2d 867 (1963); Keener v. Korn, 46 N.C. App. 214, 264 S.E.2d 829 (1980).

Cited in West v. Murphy, 197 N.C. 488, 149 S.E. 731 (1929); Brown v. Lewis, 197 N.C. 704, 150 S.E. 328 (1929); Merritt v. Inscoe, 212 N.C. 526, 193 S.E. 714 (1937); Early v. Tayloe, 219 N.C. 363, 13 S.E.2d 609 (1941); Perry v. Bassenger, 219 N.C. 838, 15 S.E.2d 365 (1941); Elmore v. Austin, 232 N.C. 13, 59 S.E.2d 205 (1950); Wells v. Planters Nat'l Bank & Trust Co., 265 N.C. 98, 143 S.E.2d 217 (1965); Olive v. Biggs, 276 N.C. 445, 173 S.E.2d 301 (1970); Welch v. Schmidt, 62 N.C. App. 85, 302 S.E.2d 10 (1983); Brinkley v. Day, 88 N.C. App. 101, 362 S.E.2d 587 (1987).

II. RULES OF CONSTRUCTION.

Intention of Testator. — The rule is elementary that the intention of the testator is the polar star which is to guide in the interpretation of all wills, and, when ascertained, effect will be given to it unless it violates some rule of law, or is contrary to public policy. In ascertaining this intention the language used, and the sense in which it is used by the testator is the primary source of information, as it is the expressed intention of the testator which is sought. Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960); Wing v. Wachovia Bank & Trust Co., 301 N.C. 456, 272 S.E.2d 90 (1980).

The testator's intent gathered from the entire will controls its interpretation. This rule applies to the construction of this section when it appears that the testator devised certain lands without the words of inheritance, and that his intent, gathered from a separate item of the will, was to create a defeasible estate in the first taker, contingent upon his dying at any time, whether before or after the death of the testator, leaving issue surviving him. Rees v. Williams, 165 N.C. 201, 81 S.E. 286 (1914).

The cardinal principle to be followed when construing a will is to give effect to the general intent of the testator as that intent appears from a consideration of the entire instrument. Adcock v. Perry, 52 N.C. App. 724, 279 S.E.2d 871 (1981), rev'd on other grounds, 305 N.C. 625, 290 S.E.2d 608 (1982).

The intent of the testatrix is her will and must be carried out unless some rule of law forbids it. In re Will of Wilson, 260 N.C. 482, 133 S.E.2d 189 (1963).

The basic rule of construction, and the refrain of every opinion which seeks to comprehend a testamentary plan, is that the intent of the testator is the polar star that must guide the courts in the interpretation of a will. In re Will of Wilson, 260 N.C. 482, 133 S.E.2d 189 (1963).

The rule, that an unrestricted or general devise of real property, to which is affixed, either specifically or by implication, an unlimited power of disposition in the first taker, conveys the fee and a subsequent clause in the will purporting to dispose of what remains at his death is not allowed to defeat the devise nor limit it to a life estate, as well as all rules of construction, must yield to the paramount intent of the testator as gathered from the four corners of the will. Quickel v. Quickel, 261 N.C. 696, 136 S.E.2d 52 (1964).

Primary object in interpreting a will is to give effect to the intention of the testator. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Presumption Against Intestacy. — It is a long-standing policy of the State of North Carolina to construe a will with the presumption that the testator did not intend to die intestate with respect to any part of his property. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Consideration of Will as Whole. — The intent of the testator must be ascertained from a consideration of the will as a whole and not merely from consideration of specific items or phrases of the will in isolation. Adcock v. Perry, 52 N.C. App. 724, 279 S.E.2d 871 (1981), rev'd on other grounds, 305 N.C. 625, 290 S.E.2d 608 (1982).

Ordinary Words. — Generally, ordinary words are to be given their usual and ordinary meaning, and technical words are presumed to have been used in a technical sense. Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960).

Words with Well-Defined Legal Significance. — If words or phrases are used which have a well-defined legal significance, established by a line of judicial decisions, they will be presumed to have been used in that sense, in the absence of evidence of a contrary intent. Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960).

Isolated Clauses or Sentences. — Isolated clauses or sentences are not to be considered by themselves, but the will is to be considered as a whole, and its different clauses and provisions examined and compared, so as to ascertain the general plan and purpose of the testator, if there be one. Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960).

Prior Decisions. — Little or no aid can be derived by a court in construing a will from prior decisions in other will cases. It is not sufficient that the same words in substance or even literally have been construed in other cases. It often happens that the same identical words require very different constructions according to context and the peculiar circumstances of each case. Clark v. Connor, 253 N.C. 515, 117 S.E.2d 465 (1960).

General Interest Prevails over a Particular Interest. — The provisions of this section, while laying down a rule of construction, still leave the question of the intention of the testator open for construction, and where there is a particular and a general paramount interest apparent in the same will, and they clash, the general interest must prevail. Leeper v. Neagle, 94 N.C. 338 (1886).

III. ILLUSTRATIVE CASES.

Devise of Use of Property. — Where testatrix only devised the "use of" the property so long as the beneficiaries "wish to live there," she "in plain and express words" showed an intent to devise less than the fee. While the courts have held that the devise of the "use of" property is the equivalent of a devise in fee, the rule has no application, when the will shows an intent to pass an interest that is less than a fee. Thompson v. Ward, 36 N.C. App. 593, 244 S.E.2d 485, cert. denied, 295 N.C. 556, 248 S.E.2d 735 (1978).

Gift of Personalty with Full Power to Use Is Absolute. — Where there is no residuary clause in the will and no limitation over so far as the personal property is concerned, a gift of personal property for life to the primary object of testator's bounty, with power to use "in any way that she may desire" is generally construed to be an absolute gift of the property. Worsley v. Worsley, 260 N.C. 259, 132 S.E.2d 579 (1963).

Testator devised to his daughters, B and M, all of his real estate after the death of his widow, and also to his daughter T an equal life interest therein with B and M, "or so long as the said T may remain a widow." Upon the death of the testator's widow, B and M took in remainder a fee simple estate, the intent of the testator being to provide for T, who remained unmarried and is now deceased, during her widowhood. Barbee v. Thompson, 194 N.C. 411, 139 S.E. 838 (1927).

The clause "I give, devise and bequeath" to named devisee, described realty, standing alone, constitutes a devise in fee simple. Buckner v. Hawkins, 230 N.C. 99, 52 S.E.2d 16 (1949).

The words "give, devise and bequeath," used by a testatrix in devising her property to a husband and wife as tenants by the entireties, in light of the provisions of this section, gave them a fee simple title to the devised property. Basnight v. Dill, 256 N.C. 474, 124 S.E.2d 159 (1962).

A devise of real estate to devisees "to do as they like with it," with subsequent provision that after their death whatever property is left should go to testatrix' niece, vests the fee simple in the beneficiaries first named. Taylor v. Taylor, 228 N.C. 275, 45 S.E.2d 368 (1947).

A devise generally to one person with limitation over to another of "whatever is left" at the death of the first taker is regarded as a devise in fee simple. Taylor v. Taylor, 228 N.C. 275, 45 S.E.2d 368 (1947), citing Patrick v. Morehead, 85 N.C. 62, 39 Am. Rep. 684 (1881); Carroll v. Herring, 180 N.C. 369, 104 S.E. 892 (1920).

"Cash." — The word "cash" is not such a technical one that it will have the same definite and precise meaning in all circumstances. Barnes v. Evans, 102 N.C. App. 428, 402 S.E.2d 164 (1991), aff'd, 331 N.C. 111, 413 S.E.2d 797 (1992).

The word "cash" as used in a will includes bank accounts, both checking and savings and includes certificates of deposit. Barnes v. Evans, 102 N.C. App. 428, 402 S.E.2d 164 (1991), aff'd, 331 N.C. 111, 413 S.E.2d 797 (1992).

Use of the words "other cash," as used in a will, will not be interpreted by resorting to a narrow, technical definition or interpretation. Courts must look for the meaning of these words according to the subject treated and the context in which they were used. The intention of the testator is the polar star which must guide the courts in the interpretation of wills. Barnes v. Evans, 102 N.C. App. 428, 402 S.E.2d 164 (1991), aff'd, 331 N.C. 111, 413 S.E.2d 797 (1992).

"Remaining cash and bonds" included certificates of deposit. Barnes v. Evans, 102 N.C. App. 428, 402 S.E.2d 164 (1991), aff'd, 331 N.C. 111, 413 S.E.2d 797 (1992).

Devise with Full Power of Disposal. — A devise to a husband with full power of disposal, but on certain conditions any part undisposed of by him to go to a nephew, vests a fee simple in the husband. Roane v. Robinson, 189 N.C.

628, 127 S.E. 626 (1925); Heefner v. Thornton, 216 N.C. 702, 6 S.E.2d 506 (1940).

A devise of real estate to testator's son for his own use and benefit with the expressed intent that it should vest in him absolutely with full right to dispose of it, with limitation over should he die without children surviving, if not disposed of by him during his life, gives the devisee a fee simple title. Lineberger v. Phillips, 198 N.C. 661, 153 S.E. 118 (1930).

A will devising to wife all of testator's property, with full power to manage, control, sell and dispose of it at her discretion, also provided that it was the testator's will and desire that she should devise whatever property she had not thus disposed of during her natural life, or the proceeds thereof, to the person who had been the "kindest to us in aiding and comforting us in our old age." It was held that the wife acquired a fee simple title. Weaver v. Kirby, 186 N.C. 387, 119 S.E. 564 (1923).

Devise with Limited Power of Disposal. — A general devise to testator's wife with subsequent items providing that one half the estate "remaining" at her death should go to his adopted son in fee, and the other half, in the event the wife did not dispose of the residue of the estate by will, to go to the children of L, is held to show an intent to convey an estate of less dignity than a fee simple to testator's wife, rebutting the presumption that the general devise to the wife should be construed to be in fee, the power of disposition of part of the estate, at least, being limited to disposition by will, and the widow does not have the power to convey the entire estate by deed in fee simple. Hampton v. West, 212 N.C. 315, 193 S.E. 290 (1937).

Devise with Power of Disposition Neither Expressed Nor Implied. — Where the gift to the first taker is in language sufficient, standing alone, to pass a fee simple estate, but no absolute power of disposition is expressed or necessarily implied, the gift is a life estate, provided from other clauses of the will it appears that, at the death of the first taker, testator intends and directs a limitation over to another or others. Andrews v. Andrews, 253 N.C. 139, 116 S.E.2d 436 (1960).

Devise for Life with Remainder to Heirs. — When a devise is to a named person for life with remainder after his death to "his heirs" or "his bodily heirs" or the "heirs of his body," nothing else appearing, the devisee becomes seized of a fee simple estate upon the death of the testator subject to any prior life estate created by the will. Hammer v. Brantley, 244 N.C. 71, 92 S.E.2d 424 (1956).

Devise Vesting Fee in Children. — A devise of land with provision that the rents should be used by testator's wife and children until they should become of age, and that the lands should be divided among them all upon the children coming of age or upon the prior death of the widow, with further provision that they should have no right to sell the lands except to each other, was held upon the death of the widow, to vest in fee simple in the children. Langston v. Wooten, 232 N.C. 124, 59 S.E.2d 605 (1950).

A devise to testator's wife of all of this estate absolutely as he held it himself, declaring that she should not be considered as holding it in trust "technically so called, to be enforced by the judge or decree of any court other than her own conscience, judgment, and affection shall prompt her to so regard it," was in fee absolute. Fellowes v. Durfey, 163 N.C. 305, 79 S.E. 621 (1913).

Devise of Proceeds of Land. — Under this section the fee generally passes upon a devise of the proceeds of land when an intention to separate the income from the principal is not expressed, or where the devise is general and the devisee is given the power of disposition, or a limitation over is made of such part as may not be disposed of by the first taker. Hambright v. Carroll, 204 N.C. 496, 168 S.E. 817 (1933).

Devise with Power of Appointment. — A devise to A, and to such persons as he shall appoint, vests the absolute property in A, without an appointment. But if it be to him for life and after his death to such person as he shall appoint, he must make an appointment in order to entitle that person to anything. The express life estate to him repels the implication of a fee simple for himself. Levy v. Griffis, 65 N.C. 236 (1871).

A devise to a trustee in trust for the sole and separate use of a married woman with a power given to her of appointing the estate in fee by deed or will, will vest the trust in her in fee under this section. Levy v. Griffis, 65 N.C. 236 (1871).

Estate Tail Converted into Fee Simple. — There was a devise of lands to wife of testator for life, and at her death or remarriage to their two children, by name, for their natural lives for the heirs of their bodies. It was held that, after the death of the widow, the devise was not a trust created in the children as trustees for the "heirs of their bodies," and there being no expression in the will to show an intent to create an estate of less degree than fee, it constituted an estate tail, converted by our statute into a fee simple. Washburn v. Biggerstaff, 195 N.C. 624, 143 S.E. 210 (1928).

There testatrix stated she "wanted" the land in question to go to her brother and at his death to his three sons and his named grandson, with further provision that at their deaths testatrix "wanted" the land to go to their "children & so on," the brother took a life estate with remainder to his children and the named grandson in fee under the rule in Shelley's Case, since it is apparent that testatrix used the word "children" in the sense of an indefinite line of succession and created an estate tail converted into a fee by G.S. 41-1. In re Will of Wilson, 260 N.C. 482, 133 S.E.2d 189 (1963).

Fee Simple Defeasible upon Condition. — Where testator devises realty to grandson, and in the event of death of the latter without children, then the land to descend to other grandchildren, such devise vests a fee simple estate in the first devisee, defeasible only on condition that he dies without leaving heirs of his body. Whitfield v. Garris, 131 N.C. 148, 42 S.E. 568 (1902); Whitfield v. Garris, 134 N.C. 24, 45 S.E. 904 (1903).

An estate "loaned" to testator's daughter R during her natural life and at her death "I lend all of the" designated land "to the lawful heirs of her body, and to the lawful begotten heirs of their bodies if any," standing alone, would convey the fee simple title, but with the further expression, "in case she should die leaving no lawful issue of her body then I give all the above described land to my son J, and his lawful heirs," the estate is defeasible in the event of the death of R "leaving no lawful issue of her body." Jarman v. Day, 179 N.C. 318, 102 S.E. 402 (1920).

Language Insufficient to Show Intent to Pass Less Than Fee Simple Estate. — See Mangum v. Wilson, 235 N.C. 353, 70 S.E.2d 19 (1952).

A devise of all testator's property, employing the words "give, devise, and bequeath" and expressing testator's desire that the estates devised and bequeathed be held intact as nearly as practicable, by marriage contract if the devisees married, and at the death of the devisees be divided among nephews and nieces, vested an absolute fee simple title in the named devisees. Humphrey v. Faison, 247 N.C. 127, 100 S.E.2d 524 (1957).

The language "provided, that if she own the property or any part thereof at her death, the same shall descend to the children born of her body, or the heirs of such children" did not show the intestator's intention to convey a life estate. An unrestricted or general devise of real property, to which is affixed, either specifically or by implication, an unlimited power of disposition in the first taker, conveys the fee and a subsequent clause purporting to dispose of what remains at his death is not allowed to defeat the devise or limit it to a life estate. Leonard v. Dillard, 87 N.C. App. 79, 359 S.E.2d 497 (1987); See Osborne v. Hodgin, 98 N.C. App. 111, 389 S.E.2d 629 (1990).

Language Showing Intention to Give Estate in Residuary Devisee of Less Dignity Than Fee Simple. — See Woodard v. Clark, 234 N.C. 215, 66 S.E.2d 888 (1951).

Where an estate is reduced from a life estate to a dower interest, in the event of remarriage, it is a manifest indication of the testator's purpose to devise his wife an estate of less dignity than a fee simple. Worsley v. Worsley, 260 N.C. 259, 132 S.E.2d 579 (1963).

Vested Remainder to Be Divested upon Condition. — Under a devise of lands to K "his lifetime, then to go to" G and M, "and if they should die without leaving bodily heirs, then to go to the Flow Heirs," it was held that, after the falling-in of the life estate, G and M take the fee in the remainder defeasible upon their dying without leaving "bodily heirs," in which event it would go to the ultimate devisees, upon the principles of a shifting use operating by way of an executory devise. Kirkman v. Smith, 174 N.C. 603, 94 S.E. 423 (1917).

For precatory words in a will to be regarded as creating a trust in lands devised, the intention of the testator to that effect must clearly appear by interpretation of the instrument, for otherwise these words must be given the ordinary significance of those of that character. Springs v. Springs, 182 N.C. 484, 109 S.E. 839 (1921).

Where the testator, after bequeathing or devising property to a person, expresses a wish or desire as to its use or disposition, such expression will not be construed to create a trust in the legatee or devisee unless it clearly appears from the instrument as a whole that testator so intended since the devise or bequest will be deemed absolute in the absence of a clearly expressed intention to convey an estate of less dignity, but precatory words will create a trust when it appears from the instrument as a whole that the testator so intended, provided testator has pointed out with sufficient clearness and certainty both the subject matter and objects of the intended trust. Brinn v. Brinn, 213 N.C. 282, 195 S.E. 793 (1938).

Subsequent Expressions Not Affecting Devise of Fee. — Where a testator devises all of his estate to his wife, clearly and unmistakably in fee, a different intent may not be inferred from subsequent expressions used in the will. Fellowes v. Durfey, 163 N.C. 305, 79 S.E. 621 (1913).

In the absence of a contrary intent expressed in the will an unrestricted or indefinite devise of real property is a devise in fee simple, and a subsequent clause expressing a wish, desire or even direction for the disposition of what remains at the death of the devisee will not be allowed to defeat the devise nor limit it to a life estate. Taylor v. Taylor, 228 N.C. 275, 45 S.E.2d 368 (1947).

Where real estate is devised in fee, or personalty bequeathed unconditionally, a subsequent clause in the will expressing a wish, desire, or direction for its disposition after the death of the devisee or legatee will not defeat the devise or bequest, nor limit it to a life estate. Worsley v. Worsley, 260 N.C. 259, 132 S.E.2d 579 (1963).

An unrestricted or general devise of real property, to which is affixed, either specifically or by implication, an unlimited power of disposition in the first taker, conveys the fee, and a subsequent clause in the will purporting to dispose of what remains at his death is not allowed to defeat the devise nor limit it to a life estate. Quickel v. Quickel, 261 N.C. 696, 136 S.E.2d 52 (1964).

An unrestricted devise followed by a provision that in the event the devisee died intestate, testator wished such devisee's share to descend to her children, vests the fee in the devisee, the precatory words being repugnant to the estate previously devised and sufficient to limit or divest it. Croom v. Cornelius, 219 N.C. 761, 14 S.E.2d 799 (1941).

Devise for "Use and Benefit without Let or Hindrance". — Where testator left property in trust with power in his wife to demand that trustee turn over property to her "for her own use and benefit without let or hindrance," upon such demand and compliance therewith, the wife takes and can convey a fee simple, notwithstanding a further provision in the will that a third person should take a life estate in property remaining in the hands of trustees at the wife's death. O'Quinn v. Crane, 189 N.C. 97, 126 S.E. 174 (1925).

Devise to Trustee Granting No Beneficial Interest. — The rule that a devise of real estate shall be construed to be in fee simple is inapplicable where the testamentary words negative the idea of the investiture of title in fee, or for life, or the granting of any other beneficial interest to the devisee, and express the intent, rather, to impose upon him duties as executor and trustee of an active trust, with directions as to the use of the property and as to how the income shall be applied during his life and after his death. Stephens v. Clark, 211 N.C. 84, 189 S.E. 191 (1937).

The construction required by this statute may not be invoked where no estate in fee is attempted to be devised and where the plain intent is not to grant an estate, but to impose a trust and direct the collection of rent for application to a specific purpose. Stephens v. Clark, 211 N.C. 84, 189 S.E. 191 (1937), citing Young v. Young, 68 N.C. 309 (1873); Witherington v. Herring, 140 N.C. 495, 53 S.E. 303, 6 Ann. Cas. 188 (1906); Fellowes v. Durfey, 163 N.C. 305, 79 S.E. 621 (1913).

Devise Creating Life Estate. — A devise for life with power of disposition creates a life estate only. Chewning v. Mason, 158 N.C. 578, 74 S.E. 357 (1912); Tillett v. Nixon, 180 N.C. 195, 104 S.E. 352 (1920); Alexander v. Alexander, 210 N.C. 281, 186 S.E. 319 (1936).

The estate devised being specifically limited to the life of the devisee, the power of disposition does not enlarge the estate devised or convert it into a fee. Hardee v. Rivers, 228 N.C. 66, 44 S.E.2d 476 (1947).

Testator devised to his wife all of his "estate real and personal," and by a later paragraph all of the rest of his property "as above stated" during her widowhood, and should she remarry her dower "according to law." It was held that only a life estate was given to his widow, the statutory presumption of a fee simple title being inoperative. Roberts v. Saunders, 192 N.C. 191, 134 S.E. 451 (1926).

Decedent's unrestricted devise of certain property to plaintiff in Item 2 was a devise in fee simple and the later devise of the property to defendants in Item 7 did not limit plaintiff's estate to a life estate. Coble v. Patterson, 114 N.C. App. 447, 442 S.E.2d 119 (1994).

Void Restraint on Alienation. — Where a restraint on alienation was declared void, the devise was unrestricted and vested the fee in the devisee. Williams v. McPherson, 216 N.C. 565, 5 S.E.2d 830 (1939).

§ 31-39. Probate necessary to pass title; recordation in county where land lies; rights of innocent purchasers.

No will shall be effectual to pass real or personal estate unless it shall have been duly proved and allowed in the probate court of the proper county, and a duly certified copy thereof shall be recorded in the office of the superior court clerk of the county wherein the land is situate, and the probate of a will devising real estate shall be conclusive as to the execution thereof against the heirs and devisees of the testator, whenever the probate thereof under the like circumstances, would be conclusive against the next of kin and legatees of the testator: Provided, that the probate and registration of any will shall not affect the rights of innocent purchasers for value from the heirs at law of the testator when such purchase is made more than two years after the death of such testator or when such purchase is made after the filing of the final account by the duly authorized administrator of the decedent and the approval thereof by the clerk of the superior court having jurisdiction of the estate. Such conveyances, if made before the expiration of the time required by this section to have elapsed in order for same to be valid against the heirs and devisees of the testator, shall, upon the expiration of such time, become good and valid to the same effect as if made after the expiration of such time, unless in the meantime a proceeding shall have been instituted in the proper court to probate the will of the testator. (1784, c. 225, s. 6; R.C., c. 119, s. 20; Code, s. 2174; Rev., s. 3139; 1915, c. 219; C.S., s. 4163; 1953, c. 920, s. 1.)

Cross References. — For further provisions as to wills fraudulently withheld from probate, see G.S. 31-12.

Legal Periodicals. — For note on the problem of after-discovered wills, see 47 N.C.L. Rev. 723 (1969).

For article discussing the doctrine of color of title in North Carolina, see 13 N.C. Cent. L.J. 123 (1982).

CASE NOTES

Probate an Indispensable Prerequisite. — The probate of a will in the proper court is an indispensable prerequisite to its validity as a conveyance of real or personal estate. Osborne v. Leak, 89 N.C. 433 (1883); Paul v. Davenport, 217 N.C. 154, 7 S.E.2d 352 (1940).

Effect of Unprobated Will. — Where the probate shows on its face that the paper-writing has never been validly proven and probated as a holographic will, it is ineffective to pass real or personal property. Morris v. Morris, 245 N.C. 30, 95 S.E.2d 110 (1956).

An unprobated will is not muniment of title; it cannot be established as a will in a collateral proceeding; it conveys no title to property until it is probated and recorded. Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965).

Will Ineffectual as Transfer of Title or Cloud Thereon during Lifetime of Testator. — A paper-writing making testamentary disposition of property is without legal significance either as a transfer of title or as a cloud thereon during the lifetime of the person executing it, since a will takes effect only upon the death of the testator and the probate of the instrument. Vandiford v. Vandiford, 241 N.C. 42, 84 S.E.2d 278 (1954).

Section Not Retroactive. — This section requiring copies of wills to be recorded in the county where the devised lands are situate, is prospective and refers only to wills proved after November 1, 1883. Curles v. Smith, 91 N.C. 172 (1884).

The 1915 amendment was prospective in effect, and the former right of devisees to have unlimited time to probate a will was not effected except from the effective date of the amendment. Barnhardt v. Morrison, 178 N.C. 563, 101 S.E. 218 (1919).

Prior to the 1915 amendment there was no limitation as to the time when a will could be probated and recorded, the ordinary registration acts having no application to a will. The will became effective from the death of the testator, ordinarily passing the title to devisees from that date against all dispositions or conveyances from the heirs to the contrary. Barnhardt v. Morrison, 178 N.C. 563, 101 S.E. 218 (1919). See Cooley v. Lee, 170 N.C. 18, 86 S.E. 720 (1915).

The amendment fixed the time at two years within which a will must be probated and recorded in order to affect the rights of innocent purchasers for value from the heirs at law, and this limitation is exclusively within the authority of the legislature to make. Barnhardt v. Morrison, 178 N.C. 563, 101 S.E. 218 (1919).

Devised property vests in devisee at time will is probated, subject to liens of deeds of trust. Cable v. Hardin Oil Co., 10 N.C. App. 569, 179 S.E.2d 829, cert. denied, 278 N.C. 521, 180 S.E.2d 863 (1971).

Hence, devisee owns equity of redemption in the property. Cable v. Hardin Oil Co., 10 N.C. App. 569, 179 S.E.2d 829, cert. denied, 278 N.C. 521, 180 S.E.2d 863 (1971).

Where, subsequent to the execution of the will, the property is subjected to the liens of various deeds of trust, these added encumbrances do not prevent the equity of redemption, which was retained by the testatrix, from passing under the will. Cable v. Hardin Oil Co., 10 N.C. App. 569, 179 S.E.2d 829, cert. denied, 278 N.C. 521, 180 S.E.2d 863 (1971).

Ownership under will is not made dependent upon the certified copy directed to be recorded in the county where the land lies. The only purpose of the certified copy is to give information to abstractors and to direct their attention to the source of title. Whitehurst v. Abbott, 225 N.C. 1, 33 S.E.2d 129, 159 A.L.R. 380 (1945).

Section 47-18, the ordinary registration act, has no application to wills. Cooley v. Lee, 170 N.C. 18, 86 S.E. 720 (1915). See Barnhardt v. Morrison, 178 N.C. 563, 101 S.E. 218 (1919).

The trial court correctly denied plaintiff's request for jury instructions to the effect that making a will passes no legal title where there was neither allegation nor evidence that any title to any property, real or personal, passed pursuant to any will. Craig v. Calloway, 68 N.C. App. 143, 314 S.E.2d 823 (1984).

Will Should Have Been Approved Where Caveators Lacked Standing to Challenge the Will. — Trial court erred by permitting the beneficiaries of the decedent's first will to proceed in a caveat proceeding against the decedent's second will without first rebutting the presumption that they lacked standing to caveat attendant to their production of a mere copy of the first will, as the presumption then existed that the decedent had revoked the first will; accordingly, the propounders of the second will were entitled to judgment. In re Will of Barnes, 157 N.C. App. 144, 579 S.E.2d 585, 2003 N.C. App. LEXIS 643 (2003), cert. denied, 357 N.C. 460, 586 S.E.2d 96 (2003), appeal dismissed, 357 N.C. 460, 586 S.E.2d 95 (2003), cert. denied, petition denied, 357 N.C. 460, 587 S.E.2d 94 (2003).

Applied in Jones v. Warren, 274 N.C. 166, 161 S.E.2d 467 (1968).

§ 31-40. What property passes by will.

Any testator, by his will duly executed, may devise, bequeath, or dispose of all real and personal estate which he shall be entitled to at the time of his death, and which, if not so devised, bequeathed, or disposed of, would descend or devolve upon his heirs at law, or upon his executor or administrator; and the power hereby given shall extend to all contingent, executory, or other future interest in any real or personal estate, whether the testator may or may not be the person or one of the persons in whom the same may become vested, or whether he may be entitled thereto under the instrument by which the same was created, or under any disposition thereof by deed or will; and also to all rights of entry for conditions broken, whether any such condition has or has not been broken at the testator's death, all other rights of entry, and possibilities of reverter; and also to such of the same estates, interests, and rights respectively, and other real and personal estate, as the testator may be entitled to at the time of his death, notwithstanding that he may become entitled to the same subsequently to the execution of his will. (1844, c. 88, s. 1; R.C., c. 119, s. 5; Code, s. 2140; Rev., s. 3140; C.S., s. 4164; 1973, c. 1446, s. 15.)

Legal Periodicals. — For article, "The Rule Against Perpetuities in North Carolina," see 57 N.C.L. Rev. 727 (1979).

For note as to the transfer of land by wills in light of Stephenson v. Rowe, 315 N.C. 330, 338 S.E.2d 301 (1986), see 65 N.C.L. Rev. 1488 (1987).

CASE NOTES

A conveyance of "all the property I possess," where there is no apparent motive for making an exception, conveys all property the party owned. Hollowell v. Manly, 179 N.C. 262, 102 S.E. 386 (1920).

Construction of "and also to all rights of entry for conditions broken," etc., prior to 1973 amendment. — See Church v. Young, 130 N.C. 8, 40 S.E. 691 (1902).

Where a will is susceptible to two reasonable constructions, one disposing of all of the testator's property, and the other leaving part of the property undisposed of, the former construction will be adopted and the latter rejected, there being a presumption against partial intestacy. Holmes v. York, 203 N.C. 709, 166 S.E. 889 (1932); Wing v. Wachovia Bank & Trust Co., 301 N.C. 456, 272 S.E.2d 90 (1980).

Items of will disposing of real estate not owned by testator were held valid to the extent that they disposed of real and personal property owned by the testator. Taylor v. Taylor, 243 N.C. 726, 92 S.E.2d 136 (1956).

Cited in Wachovia Bank & Trust Co. v. Waddell, 234 N.C. 454, 67 S.E.2d 651 (1951); Honeycutt v. Citizens Nat'l Bank, 242 N.C. 734, 89 S.E.2d 598 (1955).

§ 31-41. Will relates to death of testator.

Every will shall be construed, with reference to the real and personal estate comprised therein, to speak and take effect as if it had been executed immediately before the death of the testator, unless a contrary intention shall appear by the will. (1844, c. 88, s. 3; R.C., c. 119, s. 16; Code, s. 2141; Rev., s. 3141; C.S., s. 4165.)

CASE NOTES

This section has no retroactive effect, and does not apply to wills made prior to its enactment, though the testator dies subsequent to its enactment. Such wills, with reference to the property they devise, speak as of the date of their execution, and not as of the date of testator's death under the rule of construction promulgated by this section. Williamson v. Williamson, 58 N.C. 142 (1859).

Section Relates to Subject Matter and Not to Objects of Will. — This section, making the will speak from the death of the testator, relates to the subject matter of disposition only, and does not in any manner interfere with the construction in regard to the objects of the gift. Robbins v. Windley, 56 N.C. 286 (1857); Hines v. Mercer, 125 N.C. 71, 34 S.E. 106 (1899); Thomas v. Thomas, 258 N.C. 590, 129 S.E.2d 239 (1963).

General rule is that a will speaks as of the date of the death of the testator, and any property acquired after the making of a will, by reversion or otherwise, is subject to its terms. Ferguson v. Ferguson, 225 N.C. 375, 35 S.E.2d 231 (1945).

The general rule seems to be established that where a testator uses general terms, as "all of my estate" or "all of my lands or real estate," then the devise will speak at the date of his death. Hines v. Mercer, 125 N.C. 71, 34 S.E. 106 (1899).

A will takes effect and speaks as of the date of the testator's death. Wachovia Bank & Trust Co. v. McKee, 260 N.C. 416, 132 S.E.2d 762 (1963).

Construed as If Executed Immediately Prior to Death. — As to the property devised or bequeathed, the will is construed as if executed immediately prior to the testator's death. Peele v. Finch, 284 N.C. 375, 200 S.E.2d 635 (1973).

And in Light of Circumstances at Time It Was Made. — While the dispositive provisions of a will speak as of the death of the testator, in ascertaining testator's intent the will must be considered in the light of the conditions and circumstances existing at the time it was made. Wachovia Bank & Trust Co. v. Green, 239 N.C. 612, 80 S.E.2d 771 (1954).

Will Relates Back to Death When Probated and Recorded. — Once a will is admitted to probate and recorded by the clerk, it relates back to the death of the testator. Hargrave v. Gardner, 264 N.C. 117, 141 S.E.2d 36 (1965).

Exception to General Rule. — Ordinarily a will will be construed as though executed immediately prior to testator's death, and it is only when the will describes a specific subject of gift with sufficient particularity to show that an object in existence at the date of the execution of the will was intended that the general rule is excluded. Tyer v. Meadows, 215 N.C. 733, 3 S.E.2d 264 (1939).

Although this section ordinarily requires that a will be construed as though executed immediately prior to the testator's death, this section will not be applied in a blind or mechanical manner and that other appropriate factors may be considered. Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

Where the testator refers to a specific subject of gift, with sufficient particularity in the description of the specific subject of it, showing that an object in existence at the date of his will was intended, referring to the existing state of things at the date of the will and not at his death, then the operation of the general rule is excluded. The death is a prospective event, but the date of the will refers to actual conditions. Hines v. Mercer, 125 N.C. 71, 34 S.E. 106 (1899).

Effect of Mental Incompetence on Testamentary Capacity. — A will generally reflects the testator's testamentary intent as of the date of his death. When a person becomes mentally incompetent, however, that person ceases to be able to form testamentary intent. In such cases, it would defy reason to hold that a testator's will reflected his testamentary intent as of the date of his death, even though it had been legally determined that the testator was incapable of forming a testamentary intent for many years prior to that date. Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979).

Construction of Will as to Identity of Devisee or Legatee. — As to the identity of the devisee or legatee, a will is to be construed, nothing else appearing, in the light of circumstances known to the testator at the time of its actual execution. Peele v. Finch, 284 N.C. 375, 200 S.E.2d 635 (1973); Palmer v. Ketner, 29 N.C. App. 187, 223 S.E.2d 913 (1976).

Devise of "the Whole of My Lands" Passes After-Acquired Property. — A devise of "the whole of my lands" to devisees, includes land acquired by the testator after the publication of his will when no intention to the contrary appears. A subsequent clause in the will, directing "my other property of every kind not before mentioned to be sold," refers to other personal property. Edwards v. Warren, 90 N.C. 604 (1884).

Date on Will Immaterial. — When a writing purporting to be a will has been duly probated and thereby determined to be the last will of the deceased, it is effective as of the moment of testator's death, and the date appearing on the instrument then becomes immaterial. In re Marks' Will, 259 N.C. 326, 130 S.E.2d 673 (1963).

Devise of Interest in Another's Estate. — Inasmuch as a will speaks as of the time of testator's death, a devise by O of her "undivided interest and property in the estate of the late G.C." passes no such part of the distributive share in such estate as has been collected and received by O, for, immediately upon its payment to O, it became her property and ceased to be a part of the estate of G.C. Aydlett v. Small, 115 N.C. 1, 20 S.E. 163 (1894).

Designation of Quantity of Land Does not Prevent Operation of Rule. — Where a testator devised his lands south of a certain line, "containing by estimation two hundred acres," and subsequently he purchased other lands south of the line, the reference to the number of acres did not prevent the latter lands being included in the devise. Brown v. Hamilton, 135 N.C. 10, 47 S.E. 128 (1904).

Agreement to Sell Made Before Testator's Death. — Devise in will was not adeemed because of agreement to sell made before death when at the time of the testator's death, he retained legal title to the real estate. Morrison v. Grandy, 115 N.C. App. 170, 443 S.E.2d 751 (1994).

Land under Contract of Purchase after Execution of Will. — In re Champion, 45 N.C. 246 (1853), the devise was to testator's wife: Item 1: "All my real estate, consisting of several lots in Shelby," etc., and in Item 2: "All of my personal estate of whatever nature." After the date of the will he contracted to purchase another tract, but had not paid for it at his death. It was held that his rights in the unpaid for land passed to his wife, on the ground that looking at the whole instrument, the intention to give the whole estate to his wife was manifest. Hines v. Mercer, 125 N.C. 71, 34 S.E. 106 (1899).

Specific Bequest of Stock Did Not Include Accretion from Stock Split. — A specific bequest of common stock took effect as if the bequest were made immediately before the testator's death, and consequently the bequest did not include accretions resulting from a stock split occurring subsequent to the execution of the will and prior to testator's death. North Carolina Nat'l Bank v. Carpenter, 12 N.C. App. 19, 182 S.E.2d 3 (1971), aff'd, 280 N.C. 705, 187 S.E.2d 5 (1972).

Or Accretion from Recapitalization. — Where testator owned 900 shares of the stock of a corporation at the time he executed a will bequeathing 10 shares of the stock to his employee, and, as a result of a recapitalization, the 900 shares were retired and 250,000 shares of new stock were issued to testator in lieu thereof prior to testator's death, the employee was entitled to receive under the will only 10 shares of the stock as it existed at testator's death without accretions resulting from the recapitalization. North Carolina Nat'l Bank v. Carpenter, 280 N.C. 705, 187 S.E.2d 5 (1972).

Applied in Gatling v. Gatling, 239 N.C. 215, 79 S.E.2d 466 (1954); Wachovia Bank & Trust Co. v. Andrews, 264 N.C. 531, 142 S.E.2d 182 (1965).

Cited in Wright v. Wright, 198 N.C. 754, 153 S.E. 321 (1930); Vandiford v. Vandiford, 241 N.C. 42, 84 S.E.2d 278 (1954).

§ 31-42. Failure of devises by lapse or otherwise; renunciation; 120-hour survivorship requirement, revised simultaneous death act, Article 24, Chapter 28A.

(a) Unless the will indicates a contrary intent, if a devisee predeceases the testator, whether before or after the execution of the will, and if the devisee is a grandparent of or a descendant of a grandparent of the testator, then the issue of the predeceased devisee shall take in place of the deceased devisee. The devisee's issue shall take the deceased devisee's share in the same manner that the issue would take as heirs of the deceased devisee under the intestacy provisions in effect at the time of the testator's death. The provisions of this section apply whether the devise is to an individual, to a class, or is a residuary devise. In the case of the class devise, the issue shall take whatever share the deceased devisee would have taken had the devisee survived the testator; in the event the deceased class member leaves no issue, the devisee's share shall devolve upon the members of the class who survived the testator and the issue of any deceased members taking by substitution.

(b) Unless the will indicates a contrary intent, if the provisions of subsection (a) of this section do not apply to a devise to a devisee who predeceases the testator, or if a devise otherwise fails, the property shall pass to the residuary devisee or devisees in proportion to their share of the residue. If the devise is a residuary devise, it shall augment the shares of the other residuary devisees, including the shares of any substitute takers under subsection (a) of this section. If there are no residuary devisees, then the property shall pass by intestacy.

(c) Renunciation of a devise is as provided for in Chapter 31B of the General Statutes.

(c1) The determination of whether a devisee has predeceased the testator shall be made as provided by Article 24 of Chapter 28A of the General Statutes.

(d) As used in this section, "devisee" means any person entitled to take real or personal property under the provisions of a will. (1844, c. 88, s. 4; R.C., c. 119, s. 7; Code, s. 2142; Rev., s. 3142; 1919, c. 28; C.S., s. 4166; 1951, c. 762, s. 1; 1953, c. 1084; 1965, c. 938, s. 1; 1975, c. 371, s. 3; 1979, c. 525, s. 5; 1987, c. 86, ss. 1, 2; 1989, c. 244; 1999-145, s. 1; 2001-83, s. 1; 2007-132, ss. 3(a), (b).)

Cross References. — As to intestate succession, see G.S. 29-1 et seq.

Effect of Amendments. — Session Laws 2007-132, ss. 3(a) and (b), effective October 1, 2007, and applicable to determinations of title to or devolution of property dependent upon the death of an individual occurring on or after that date, added "120-hour survivorship requirement, revised simultaneous death act, Article 24, Chapter 28A" in the section heading and added subsection (c1).

Legal Periodicals. — For brief comment on 1951 amendment, see 29 N.C.L. Rev. 425 (1951).

For article on lapse, abatement and ademption, see 39 N.C.L. Rev. 313 (1961).

For note concerning adopted children as issue, see 40 N.C.L. Rev. 650 (1962).

For survey of 1976 case law on wills, trusts and estates, see 55 N.C.L. Rev. 1109 (1977).

For article, "Class Gifts in North Carolina — When Do We 'Call The Roll'?," see 21 Wake Forest L. Rev. 1 (1985).

For legislative survey of trusts and estates, see 22 Campbell L. Rev. 253 (2000).

CASE NOTES

I. General Consideration.
II. Property Passing Under Residuary Clause.
III. Devise or Legacy to Testator's Slayer.

I. GENERAL CONSIDERATION.

Editor's Note. — *Some of the cases cited below were decided under this section as it appeared prior to the 1951 amendment and former G.S. 31-42.1 and 31-42.2.*

Legislative Intent. — The legislature did not intend that the issue of a devisee or legatee meeting the conditions of subsection (a) could be substituted for that devisee or legatee as to a specific devise or bequest and not allowed to be similarly substituted if the same devisee or legatee were named as one of the residuary devisees or legatees. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Construction. — Subsection (a) of this section is designed and intended to prevent the lapse of a devise or bequest, whether it be specific or residuary, in a situation where the devisee or legatee, who would have taken had he survived the testator, predeceases testator survived by issue who survive the testator and who would have been heirs of testator had there been no will. If this situation does not exist, then the devise or legacy lapses and passes under the provisions of subdivision (c)(1) under the residuary or by intestacy, if there be no residuary. If lapse of a residuary devise or legacy cannot be prevented by application of subsection (a), then under subdivision (c)(2) it continues a part of the residue and passes to the other residuary legatees or devisees, if any. If none, it passes as if testator had died intestate with respect thereto. That this construction manifests the intent of the legislature is further evidenced by the clear language of the statute itself. Subdivision (c)(2) is applicable, with respect to residuary devises or legacies, only where subsection (a) is not applicable. It would follow, that if the legislature had intended to exclude residuary devises and legacies from the operation of subsection (a), it would have specifically limited the section to specific legacies and devises, omitted subdivision (2) from the provisions of subsection (c), and treated residuary devises and legacies in a separate provision of the statute unrelated to any other section. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969); Misenheimer v. Misenheimer, 62 N.C. App. 506, 303 S.E.2d 415 (1983), aff'd, 312 N.C. 692, 325 S.E.2d 195 (1985) (decided under prior law).

Original Section a Copy of English Statute. — This section, as enacted in 1844 was a copy of the English statute upon the same subject. Holton v. Jones, 133 N.C. 399, 45 S.E. 765 (1903).

This section is not ambiguous. The intention of the General Assembly in its enactment of this section is expressed in language which leaves no room for judicial construction. The distinction found in the common law for purposes of devolution is recognized and preserved. Farnell v. Dongan, 207 N.C. 611, 178 S.E. 77 (1935); Beach v. Gladstone, 207 N.C. 876, 178 S.E. 546 (1935).

This section applies to all wills and provides means by which property is to be distributed in the event of failure of devises and legacies by lapse or otherwise. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

This section is applicable to wills of persons dying on or after July 1, 1965. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Prior to the 1965 amendment, in a situation where testator gave the residue of his estate to A, B, and C, and A predeceased testator leaving no issue entitled to the property under the antilapse statute. A's share would pass to the heirs of testator as intestate property. After the 1965 amendment the application thereof would result in A's share continuing as a part of the residue for division among the other residuary legatees and devisees. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Subsection (a) applies to residuary devises or bequests. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Anti-lapse statute did not apply to case regarding distribution of proceeds from annuity contract. Hager v. Lincoln Nat'l Life Ins. Co., 126 N.C. App. 349, 484 S.E.2d 828 (1997).

Limitation Over Held to Lapse. — Where testatrix left property in trust to her son for life with remainder over to his issue, and in the event the son should leave no issue, to testatrix's brothers and sisters, and all except one of testatrix's brothers and sisters predeceased her, and the sister who survived her died during the lifetime of the son, the limitation over to the brothers and sisters of testatrix lapsed, since the children of the brothers and sisters of testatrix who predeceased testatrix did not qualify under this section, and no transmittable estate vested in the sister of testatrix who died during the lifetime of testatrix's son. Poindexter v. Wachovia Bank & Trust Co., 258 N.C. 371, 128 S.E.2d 867 (1963).

Intent to Prevent Lapse. — Should the testator desire to prevent lapse, he must express his intent that the gift not lapse or must provide for substitution of another devisee to receive the gift. In re Hubner, 106 N.C. App. 204, 416 S.E.2d 401, cert. denied, 332 N.C. 148, 419 S.E.2d 572 (1992).

Had testator intended the anti-lapse statute not to apply, he could have very easily shown such contrary intent, and it was not for the court to do that for him. Early v. Bowen, 116 N.C. App. 206, 447 S.E.2d 167, 1994 N.C. App. LEXIS 906 (1994), cert. denied, 339 N.C. 611, 454 S.E.2d 249 (1995), cert. denied, 456 S.E.2d 519 (1995).

Trial court improperly applied the anti-lapse statute, G.S. 31-42(a), to devises in a will to a son who predeceased the testatrix, because an article in the will specifically provided that any lapsed devises were to pass in the testatrix's residuary estate. Colombo v. Stevenson, 150 N.C. App. 163, 563 S.E.2d 591, 2002 N.C. App. LEXIS 365 (2002), aff'd, 357 N.C. 157, 579 S.E.2d 269 (2003) .

Decedent's failure to execute a will devising his interest in farmland to his son, which decedent promised to do in a separation agreement, caused his interest in that land to pass to the second wife, and not the minor grandchild after the son predeceased the decedent; accordingly, the trial court should not have granted summary judgment to the estate representative and the second wife because the minor grandchild had an action for specific performance of the agreement, even though he was not named in it, since the property upon the death of the decedent would have passed to the minor grandchild pursuant to G.S. 31-42. Tyndall-Taylor v. Tyndall, 157 N.C. App. 689, 580 S.E.2d 58, 2003 N.C. App. LEXIS 926 (2003).

Intestacy Not Favored. — No one supposes that he has failed in his intention to dispose of all of his property by his will, and the courts should endeavor to make out such an intention and to uphold the testamentary plan, so that the testator may not, as to some of his estate, have died intestate. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

Legacy Not Lapsed by Fact That Legatee Predeceased Testator. — A judgment that a legacy did not lapse by reason of fact that legatee predeceased testator was affirmed, it appearing that legatee would have been distributee of testator had she survived him.

Beach v. Gladstone, 207 N.C. 876, 178 S.E. 546 (1935).

Lapse Would Cause Impermissible Rewriting of the Will. — To conclude from the survivor language of testator's will that his intent was to favor the children of the brother who lived longest over the children of the brother who died first was an impermissible rewriting of the will rather than a construction of what was contained within the four corners of the document. Early v. Bowen, 116 N.C. App. 206, 447 S.E.2d 167, 1994 N.C. App. LEXIS 906 (1994), cert. denied, 339 N.C. 611, 454 S.E.2d 249 (1995), cert. denied, 456 S.E.2d 519 (1995).

Who Are Distributees. — A distributee is a person who has the right under the statute of distribution to a share in the surplus estate of an intestate; one entitled to take a share of an estate of a decedent, under the statute of distribution; one to whom something has to be distributed in the division of an estate; a person upon whom personal property devolves by act of law in cases of intestacy. The determinative criterion is the right to share in the distribution of the personal estate of the intestate. Those who take by succession the estate of a person who dies intestate are named and defined in G.S. 28-149 (now G.S. 29-1 et seq.). Wachovia Bank & Trust Co. v. Shelton, 229 N.C. 150, 48 S.E.2d 41 (1948).

Must Be Determined as of Date of Death of Testatrix. — Who would have been distributees of the estate had the testatrix died intestate must be determined as of the date of her death and not as of the date of the execution of her will. Wachovia Bank & Trust Co. v. Shelton, 229 N.C. 150, 48 S.E.2d 41 (1948).

Wife Surviving Testator Not Heir at Law but Distributee. — Where the owner of real and personal property executed a will devising and bequeathing all his property, both real and personal, to his wife, the collateral heirs at law of the testator are entitled to the real property, the devise to the wife having lapsed by reason of her prior death, and the provisions of this section, not applying to prevent such lapse of the devise, since the wife would not have been an heir at law of testator had she survived him, but the children of the wife by a prior marriage are entitled to the personalty, since the wife would have been a distributee of the personal estate of her husband had she survived him, and this section providing that in such case the legacy should not lapse, but should go to the surviving issue of the legatee, the statute clearly recognizing the distinction between real and personal property for the purposes of devolution. Farnell v. Dongan, 207 N.C. 611, 178 S.E. 77 (1935).

Where a wife dies leaving her husband but no issue he is her sole distributee, and her collateral kin are not entitled to share in the estate and are not "distributees." Wachovia Bank & Trust Co. v. Shelton, 229 N.C. 150, 48 S.E.2d 41 (1948).

Standing of Adopted Child. — Where a parent by adoption is named a legatee in the will of her mother, but dies prior to the death of her mother, the adopted child takes the personalty bequeathed his mother by adoption under this section, even though the adoption was subsequent to the execution of the will, since under the provisions of G.S. 48-23 the adopted child has the same standing as though he had been born to his adoptive parent at the time of the adoption. Headen v. Jackson, 255 N.C. 157, 120 S.E.2d 598 (1961).

Devise Void for Vagueness of Description. — Where a testator attempted to devise to named devisees separate tracts of land described simply as, first, "my home and 30 acres of land surrounding the same," second, "12 acres of my Plantation located in the Northwest corner of same," and third, "12 acres on the East side of my Plantation," a fourth item which attempted to devise the "remainder of my real estate" constituted an attempted specific devise of a particular tract, rather than a general residuary clause, and, the first three items being void for vagueness of description, the fourth item was also void. Taylor v. Taylor, 45 N.C. App. 449, 263 S.E.2d 351, rev'd on other grounds, 301 N.C. 357, 271 S.E.2d 506 (1980).

A renunciation is not a grant of legal title by the renouncer. It merely triggers a set of statutorily defined legal rights which ultimately determine ownership. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under § 29-10 as it read prior to Oct. 1, 1975.

A renunciation relates back to the death of the testator or intestate. The renouncer never actually holds legal title to the property. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under § 29-10 as it read prior to Oct. 1, 1975.

A parol trust may not be engrafted upon a renounced interest. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under § 29-10 as it read prior to Oct. 1, 1975.

Action Seeking Constructive Trust. — Plaintiff, who sought to assert that defendant unduly influenced his decision to sign a "Petition to Renounce" his interest in will, could maintain an action seeking the declaration of a constructive trust. Hinson v. Hinson, 80 N.C. App. 561, 343 S.E.2d 266 (1986), decided under § 29-10 as it read prior to Oct. 1, 1975.

Estate Passed into Intestacy Where Devise to Predeceased Spouse Lapsed and Will Had No Residuary. — Since the decedent's husband predeceased the decedent, the will's devise to the husband lapsed, and since he was neither a grandparent of nor a descendant of a grandparent of the decedent, and had no issue, G.S. 31-42(b) controlled; where a condition precedent to a beneficiary taking under the decedent's will did not occur and the will had no residuary clause, the estate passed by intestacy. Grant v. Cass, 173 N.C. App. 745, 620 S.E.2d 299, 2005 N.C. App. LEXIS 2255 (2005).

Applied in Rape v. Lyerly, 287 N.C. 601, 215 S.E.2d 737 (1975); Forester v. Marler, 31 N.C. App. 84, 228 S.E.2d 646 (1976); Tighe v. Michal, 41 N.C. App. 15, 254 S.E.2d 538 (1979); Taylor v. Taylor, 301 N.C. 357, 271 S.E.2d 506 (1980); North Carolina Nat'l Bank v. Apple, 95 N.C. App. 606, 383 S.E.2d 438 (1989).

Cited in Rodman v. Rodman, 21 N.C. App. 397, 204 S.E.2d 695 (1974); Adcock v. Perry, 305 N.C. 625, 290 S.E.2d 608 (1982); Betts v. Parrish, 62 N.C. App. 77, 302 S.E.2d 288 (1983); McMillan v. Davis, 81 N.C. App. 433, 344 S.E.2d 595 (1986); In re Estate of Baumann, 93 N.C. App. 782, 379 S.E.2d 107 (1989); Lewis v. Ecklin, 110 N.C. App. 73, 428 S.E.2d 855 (1993).

II. PROPERTY PASSING UNDER RESIDUARY CLAUSE.

Residuary Clause Comprises All Property Not Otherwise Provided for. — It was intended by this section that the property passing by residuary clause of a will should comprise all the estate owned by the testator at time of his death not otherwise specifically devised or provided for, and should include any described in a devise which may have lapsed, or become void or incapable of taking effect. Renn v. Williams, 233 N.C. 490, 64 S.E.2d 437 (1951).

Construction of Residuary Clause in General. — In a residuary gift large enough in its language to comprehend residue, the question is, not what is included, but what is excluded; and one must find words sufficiently large, definite and distinct to enable him to say that some item is excluded, so that what hitherto has purported to be the residuary gift is reduced to the level of a specific gift, and ceases to be a residuary gift. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

No particular mode of expression is needed to constitute a residuary clause. All that is required is an adequate indication that a particular clause was intended to dispose of property which was not otherwise disposed of by the will. Betts v. Parrish, 312 N.C. 47, 320 S.E.2d 662 (1984).

Construction to Prevent Intestacy. — A residuary clause in a will should be construed so as to prevent an intestacy as to any part of the testator's estate, unless there is an apparent intent to the contrary, plainly and unequivocally expressed in the writing. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

It is a general rule always to construe a residuary clause so as to prevent an intestacy as regards any part of the testator's estate, unless there is an apparent intention to the contrary. Betts v. Parrish, 312 N.C. 47, 320 S.E.2d 662 (1984).

When the language of the will is definite and clear, the presumption that the will must be construed to prevent partial intestacy is generally not employed. If the language is unambiguous, then there is no need to resort to a construction of the will, and the expression of the testator must be given effect. Betts v. Parrish, 312 N.C. 47, 320 S.E.2d 662 (1984).

Applicability of Former Subdivision (c)(1)a. — Where it was clear from the residuary clause itself or other parts of the will, that the testator had in fact a contrary intention, namely, that the residue should not be general, and that things given away should not fall into the residue, subdivision (c)(1)a did not apply. Betts v. Parrish, 312 N.C. 47, 320 S.E.2d 662 (1984) (decided under prior law).

Applicability of Former Subdivision (c)(2). — Former subdivision (c)(2) of this section was applicable only where there were other residuary devisees or legatees named in the will who survived the testator. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Subject Matter of Void Legacy Included in Residuary Legacy. — A legacy which is void under the terms of G.S. 31-10, which makes those legacies whose beneficiaries were attesting witnesses to the will void, passes under the residuary clause of the will. Renn v. Williams, 233 N.C. 490, 64 S.E.2d 437 (1951).

Rule as to Residuary Clause Applies Only in Absence of Contrary Intention. — A lapsed devise of lands will not fall within the residuary clause of a will, under this section, where a contrary intent appears from the construction of a will itself; and where the testator has specifically devised his lands, making ample provisions for his widow, and gives her, in the residuary clause, "all other property not herein specified," and the use of the word "property," with the expression "not herein specified," shows the testator's intent that a lapsed devise of the realty should not fall within the residuary clause, but will go to the testator's next of kin instead of those of the widow or her devisees under her will. Howell v. Mehegan, 174 N.C. 64, 93 S.W. 438 (1917).

And if the will expresses an intent that a legacy shall not lapse in the event the legatee predeceases testatrix, the statutory provision for lapse does not apply. This intent need not be stated in exact terms, but is to be ascertained from the four corners of the will. Wachovia Bank & Trust Co. v. Shelton, 229 N.C. 150, 48 S.E.2d 41 (1948), wherein will showed no intent that legacy should not lapse upon prior death of legatee.

No particular mode of expression is necessary to constitute a residuary clause in a will, and while the words "rest," "residue," or "remainder" are commonly used for the purpose, naturally placed at the end of the dispositive portion of the will, all that is required is an adequate designation of what has not been otherwise disposed of; and the fact that a provision so operating is not spoken of in the will as the residuary clause is immaterial. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916); Barnacascel v. Spivey, 11 N.C. App. 269, 181 S.E.2d 151 (1971).

And It Is Dependent upon the Intention of the Testator. — Whether a clause is a residuary clause is not dependent upon any particular form of expression but upon the intention of the testator, and where a will provides that after the termination of a life estate that the whole estate should be reduced to cash and, after payment of certain specific bequests, distributed among a specific class, where the legacy of one of the class lapses by the death of the legatee prior to the testator's death, the amount of such legacy is thrown into the fund for distribution among the class named, and it does not go to the next of kin of the legatee. Stevenson v. Wachovia Bank & Trust Co., 202 N.C. 92, 161 S.E. 728 (1932).

"Residuary Devisee." — Residuary devisee is defined as the person named in a will, who is to take all the real property remaining over and above the other devises. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969).

"Residuary Legatee." — Residuary legatee is defined as the person to whom a testator bequeaths the residue of his personal estate, after the payment of such other legacies as are specifically mentioned in the will. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969).

"The Other Residuary Devisees or Legatees, If Any." — This section, by use of the words "the other residuary devisees or legatees, if any," refers to those residuary devisees or legatees named in the will and not to "such issue of the devisee or legatee as survive testator" who may have been substituted under subsection (a) of this section. Bear v. Bear, 3 N.C. App. 498, 165 S.E.2d 518 (1969) (decided under prior law).

Heirs who partake of a devise pursuant to this section are entitled to a share of a lapsed residuary gift; if the predecessor would have taken a share of a lapsed residuary gift, then the qualified issue may also have participated in this lapsed gift. In re Will of Hubner, 105 N.C. App. 599, 414 S.E.2d 369 (1992).

Language disposing of property "not expressly disposed of by other provisions of the will" was a residuary clause and the decision concerning the taking of the lapsed share was controlled by *In re Will of Huber*, 106 N.C. App. 204, 416 S.E.2d 401 (1992). Moore v. Stern, 122 N.C. App. 270, 468 S.E.2d 607 (1996).

"All of the Residue" Embraces Personalty and Realty. — General words in a residuary clause of a will, "all of the residue," etc., embrace every species of property, whether real or personal, owned by the testator at his death, unless restricted by the context. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

Devise Passing under Residuary Clause. — It is settled law in this jurisdiction, by reason of the provisions of this section, that where a contrary intent does not appear in a will, ordinarily a lapsed, void or rejected devise will pass under an effective residuary clause. Featherstone v. Pass, 232 N.C. 349, 60 S.E.2d 236 (1950).

Devise of Lapsed Residuary Gift. — Heirs who partake of a devise pursuant to the antilapse statute are entitled to a share of a lapsed residuary gift. In re Hubner, 106 N.C. App. 204, 416 S.E.2d 401, cert. denied, 332 N.C. 148, 419 S.E.2d 572 (1992).

Where residuary legatees would have taken a share of a lapsed gift had they survived, their daughters, who were qualified issue, could take the entire share to which residuary legatees would have taken had they survived. In re Hubner, 106 N.C. App. 204, 416 S.E.2d 401, cert. denied, 332 N.C. 148, 419 S.E.2d 572 (1992).

Devise Not Passing under Residuary Clause. — Testator devised certain property to his sister for life, remainder to the county to be used as a charitable hospital, with further provision that if the property should not be so used, the county should forfeit the right of possession and title, and the property pass to testator's heirs at law. It was held that upon the renunciation by the county after the death of the life tenant, the remainder passes to testator's heirs in accordance with the expressed intent of testator, leaving no interest to pass under the subsequent residuary clause of the will. Featherstone v. Pass, 232 N.C. 349, 60 S.E.2d 236 (1950).

Effect of Failure to Name Devisee. — There was a devise of land "to my ...." without naming the devisee, followed by a residuary clause of the will, "that all of the residue of my estate be sold, and if there should be any surplus over the payment of debts and expenses, that such surplus be equally divided and paid over" to certain named persons. It was held, that the failure to name the devisee brings the devise within the terms of the statute as to void devises, or those incapable of taking effect, and the property devised will go to the residuary legatees, and not to the heirs at law. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

Devise Failing for Misdescription. — A general residuary bequest carries lapsed and void legacies, and property which is the subject of a devise which fails by reason of a misdescription. Faison v. Middleton, 171 N.C. 170, 88 S.E. 141 (1916).

Subject Matter of Void Legacy Included in Residuary Legacy. — Under the provisions of this section, the property which is the subject matter of a void legacy, is included within the residuary legacy provided by the will, and should be delivered by the executor to the residuary legatees. Wilmington Sav. & Trust Co. v. Cowan, 208 N.C. 236, 180 S.E. 87 (1935).

Lapse of Shares of Some of Residuary Legatees. — Where the testator has named several beneficiaries in a residuary clause, and it appears upon the face of the will that several of these names have been run through with a pen, and the intention of the testator to revoke has been established, the beneficiaries whose names have been thus erased take nothing, and the whole estate, under the residuary clause, goes to the others therein named together with such legacies as may have lapsed. Barfield v. Carr, 169 N.C. 574, 86 S.E. 498 (1915).

III. DEVISE OR LEGACY TO TESTATOR'S SLAYER.

Subsection (a) Rather Than Subdivision (c)(2) Applies. — If the court were to hold that subdivision (c)(2) of this section applies merely because the slayer does not, in fact, predecease the slain, the court would be ignoring the legislative scheme intended by the statutory presumption of the slayer's death. Moreover, subsection (c) expressly states that that subsection applies only if subsection (a) is not applicable, thus making subsection (a) the dominant or controlling statute. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Presumption in § 31A-4(3) Equivalent to Actual Death. — It was the intent of the General Assembly that the presumption in G.S. 31A-4(3) be equivalent to actual death for all purposes of determining the disposition of property of the testator. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Distributed in Accord with Subsection (a). — Because of the failure of a slayer's legacy, the property that would have gone to him under the will had he not been convicted of killing the testator must be distributed in accord with subsection (a). Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

Where slayer's two children are alive and would have been heirs of testator had he died intestate, slayer's failed legacy must pass by substitution to them in accordance with subsection (a). Because of the conclusive presumption in G.S. 31A-4(3) that the slayer predeceased the testator, subsection (a), not subdivision (c)(2), applies. Misenheimer v. Misenheimer, 312 N.C. 692, 325 S.E.2d 195, rehearing denied, 313 N.C. 515, 334 S.E.2d 778 (1985).

§§ 31-42.1, 31-42.2: Repealed by Session Laws 1965, c. 938, s. 2.

Cross References. — For similar provisions, see G.S. 31-42.

§ 31-43. General gift by will an execution of power of appointment.

A general devise of the real estate of the testator, or of his real estate in any place or in the occupation of any person mentioned in the will, or otherwise described in a general manner, shall be construed to include any real estate, or any real estate to which such description shall extend, as the case may be, which he may have power to appoint in any manner he may think proper; and shall operate as an execution of such power, unless a contrary intention shall appear by the will; and in like manner a bequest of the personal estate of the testator, or any bequest of personal property, described in a general manner, shall be construed to include any personal estate, or any personal estate to which such description shall extend, as the case may be, which he may have power to appoint in any manner he may think proper, and shall operate as an execution of such power, unless a contrary intention shall appear by the will. (1844, c. 88, s. 5; R.C., c. 119, s. 8; Code, s. 2143; Rev., s. 3143; C.S., s. 4167.)

Cross References. — As to execution of power of appointment by will, see G.S. 31-4.

Legal Periodicals. — For article on estate planning and powers of appointment, see 30 N.C.L. Rev. 225 (1953).

For survey of 1977 law on wills, trusts and estates, see 56 N.C.L. Rev. 1152 (1978).

For note, "Powers of Appointment—Does a General Residuary Clause Fulfill a Specific Reference Requirement?," see 65 N.C.L. Rev. 1475 (1987).

CASE NOTES

Purpose of Section. — It has been suggested that this section was passed to guard against the inadvertence of a life tenant with a general power of appointment. Accustomed throughout his life to treating the land as if it were his in fee, he might overlook making a specific appointment of the particular property and attempt to dispose of it by a general devise. In such event, if he owned other property which would pass under the devise, the power remained unexecuted and his devisees lost the property by his default. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966); First Citizens' Bank & Trust Co. v. Fleming, 77 N.C. App. 568, 335 S.E.2d 515 (1985).

This section is identical with § 27 of the English Wills Act of 1837 (7 Wm. IV & 1 Vict. ch. 26). Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966).

Which Is Held Applicable Only to General Powers. — Construing the Wills Act of 1837, the English courts have held that G.S. 27, which is identical with this section, is applicable only to general powers of appointment. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966).

As Is This Section. — The effect of this section is that a general devise or bequest shall be construed to include any real or personal property which the testator may have power to appoint in any manner he may think proper and shall operate as an execution of such power unless a contrary intention appears in the will. A power to appoint in any manner the donee may think proper is a power upon which no restrictions are imposed — a general power. This section thus applies only to general powers of appointment. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966).

The case of Johnston v. Knight, 117 N.C. 122, 23 S.E. 92 (1895), merely applied the rule that where the donee of a power, general or special, clearly manifests an intention to execute it, effect will be given to his intent. It did not extend the applications of this section to special powers. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966).

Hence, Special Power Is Not Executed by General Devise Not Showing Such Intent. — A general devise by a testator to his wife cannot be construed to include trust property over which he had a special or limited power of appointment, where his will discloses no intent to execute the power, since this section applies only to general powers. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 148 S.E.2d 41 (1966).

Conveyance in General Terms. — Whether a conveyance of property in general terms or by general description constitutes a valid exercise of a power of appointment is governed by this section in respect to the exercise of such power by will. Schaeffer v. Haseltine, 228 N.C. 484, 46 S.E.2d 463 (1948).

Intent Manifested by Entire Will. — Where the execution by will of a power is not exercised in express terms by reference to the power or the subject, a construction must be given by looking to the whole instrument and giving effect to the intent therein manifested. Johnston v. Knight, 117 N.C. 122, 23 S.E. 92 (1895); Walsh v. Friedman, 219 N.C. 151, 13 S.E.2d 250 (1941).

In order to exercise a power of appointment calling for specific reference to the power before the power may be exercised, some reference to the power must be made. First Citizens Bank & Trust Co. v. Fleming, 77 N.C. App. 568, 335 S.E.2d 515 (1985).

Residuary Devise Executes Power Unless Contrary Intention Shown. — Unless there is something to show a contrary intention on the part of a testator, a general residuary devise will operate as an execution of a power to dispose of property by will. Johnston v. Knight, 117 N.C. 122, 23 S.E. 92 (1895); Walsh v. Friedman, 219 N.C. 151, 13 S.E.2d 250 (1941).

Where the donee of a power to dispose of property by will to certain persons devises the property to such persons by a residuary clause, without referring to the power, the devise will be considered an intentional and not an accidental exercise of the power. Johnston v. Knight, 117 N.C. 122, 23 S.E. 92 (1895).

This section creates a statutory presumption in favor of exercise of a power of appointment by a residuary clause, and on its face bars any other result unless an intention contrary to exercise can be inferred from the will. Planters Nat'l Bank & Trust Co. v. United States, 425 F. Supp. 1179 (E.D.N.C. 1977).

A power of appointment upon which no restrictions are imposed is exercised by a residuary clause. First Citizens Bank & Trust Co. v.

Fleming, 77 N.C. App. 568, 335 S.E.2d 515 (1985).

Valid Exercise of Power. — Will held a valid exercise of power of appointment under this section, there being nothing in the will to indicate any contrary intent. Schaeffer v. Haseltine, 228 N.C. 484, 46 S.E.2d 463 (1948).

Cited in First Union Nat'l Bank v. Moss, 32 N.C. App. 499, 233 S.E.2d 88 (1977).

§ 31-44: Repealed by Session Laws 1951, c. 762, s. 2.

§ 31-45: Rewritten and renumbered as G.S. 31-5.5 by Session Laws 1953, c. 1098, s. 7.

§ 31-46. Validity of will; which laws govern.

A will is valid if it meets the requirements of the applicable provisions of law in effect in this State either at the time of its execution or at the time of the death of the testator. (1953, c. 1098, s. 14.)

CASE NOTES

Challenges to Validity. — Although a trial court properly granted summary judgment to an executor where there was no evidence of a lack of testamentary capacity, the trial court erred in finding estoppel and no undue influence; a caveator showed that the caveator would have received a bequest in any event and that there were genuine issues of material fact relating to undue influence. In re Will of Smith, 158 N.C. App. 722, 582 S.E.2d 356, 2003 N.C. App. LEXIS 1229 (2003).

Article 8.

Testamentary Additions to Trusts.

§ 31-47. Testamentary additions to trusts.

(a) A will may validly devise property to:

(1) The trustee of a trust established before the testator's death by the testator, by the testator and some other person, or by some other person, including a trust authorized by G.S. 36C-4-401.1; or

(2) The trustee of a trust to be established at the testator's death, if the trust is identified in the testator's will and its terms are set forth in a written instrument executed before or concurrently with the execution of the testator's will, regardless of the existence, size, or character of the corpus of the trust during the testator's lifetime.

The devise is not invalid because the trust is amendable or revocable, or because the trust instrument or any amendment thereto was not executed in the manner required for wills, or because the trust was amended after the execution of the testator's will or after the testator's death. A revocable trust to which property is first transferred under subdivision (2) of this subsection is an inter vivos trust and not a testamentary trust and, as of the date of the execution of the trust instrument, is subject to Article 6 of Chapter 36C of the General Statutes.

(b) Unless the testator's will provides otherwise, property devised to the trustee of a trust described in subsection (a) of this section is not held under a testamentary trust of the testator, but it becomes a part of the trust to which it is devised, and shall be administered and disposed of in accordance with the provisions of the governing instrument setting forth the terms of the trust, including any amendments thereto made before or after the testator's death.

(c) Unless the testator's will provides otherwise, a revocation or termination of the trust before the testator's death causes the devise to lapse.

(d) A devise to a trust shall be construed as a devise to the trustee of that trust.

(e) For purposes of this section, "devise," when used as a noun, means a testamentary disposition of real or personal property and, when used as a verb, means to dispose of real or personal property by will.

(f) Nothing in this section alters, amends, or in any manner affects the application of the doctrine of acts of independent significance. (1955, c. 388; 1957, c. 783, s. 1; 1975, c. 161; 2007-184, s. 1.)

NORTH CAROLINA COMMENT (2007)

This section is derived from Section 2-511 of the Uniform Probate Code as revised in 1990 by the National Conference of Commissioners on Uniform State Laws. The Official Comment to that section states in pertinent part, "As revised, it has been made clear that the "trust" need not have been established (funded with a trust res) during the decedent's lifetime, but can be established (funded with a res) by the devise itself."

Editor's Note. — This comment is a drafters comment printed under the authority of Session Laws 2007-184, s. 3. This comment is the comment of the original drafters of Session Laws 2007-184 and has been printed as received.

Session Laws 2007-184, s. 3, provides: "The Revisor of Statutes shall cause to be printed along with this act all relevant portions of the official comments to Sections 2-510 (Incorporation by Reference), and 2-511 (Testamentary Additions to Trusts) of the Uniform Probate Code and all explanatory comments of the drafters of this act as the Revisor deems appropriate."

Effect of Amendments. — Session Laws 2007-184, s. 1, effective July 5, 2007, and applicable to estates of decedents dying on or after that date regardless of when the will or instrument was executed, rewrote the article heading and the section.

ARTICLE 9.

Incorporation by Reference; Acts of Independent Significance.

§ 31-51. Incorporation by reference.

A writing in existence when a will is executed may be incorporated by reference if the language of the will manifests this intent and describes the writing sufficiently to permit its identification. (2007-184, s. 2.)

OFFICIAL COMMENTS

This section codifies the common law doctrine of incorporation by reference, except that the sometimes troublesome requirement that the will refer to the document as being in existence when the will was executed has been eliminated.

Editor's Note. — The official comment provided above is reprinted from the Uniform Probate Code, Copyright © 2004, National Conference of Commissioners on Uniform State Laws.

Session Laws 2007-184, s. 3, provides: "The Revisor of Statutes shall cause to be printed along with this act all relevant portions of the official comments to Sections 2-510 (Incorporation by Reference), and 2-511 (Testamentary Additions to Trusts) of the Uniform Probate Code and all explanatory comments of the drafters of this act as the Revisor deems appropriate."

Session Laws 2007-184, s. 4, made this article effective July 5, 2007, and applicable to estates of decedents dying on or after that date regardless of when the will or instrument was executed.

§ 31-52. Acts and events of independent significance.

A will may dispose of property by reference to acts and events that have significance apart from their effect upon the disposition made by the will, whether they occur before or after the execution of the will or before or after the testator's death. These acts and events may include the execution or revocation of another individual's will and the safekeeping of items in a secured depository. (2007-184, s. 2.)

NORTH CAROLINA COMMENT (2007)

The concept of "safekeeping" covers both the depositing and removal of items from the depository. Wall safes and safe deposit boxes are examples of depositories that are rebuttably presumed to be secure.

Editor's Note. — This comment is a drafters comment printed under the authority of Session Laws 2007-184, s. 3. This comment is the comment of the original drafters of Session Laws 2007-184 and has been printed as received.

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